FISCAL FEDERALISM IN BRAZIL

By

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A DISSERTATION PRESENTED TO THE GRADUATE COUNCIL OF
THE UNIVERSITY OF FLORIDA
IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE
DEGREE OF DOCTOR OF PHILOSOPHY

UNIVERSITY OF FLORIDA
1970

ACKNOWLEDGEMENTS

Many persons have contributed most welcome advice and criticism during the various stages of preparation of this dissertation. While conducting my initial research in Brazil, the staff of the Getúlio Vargas Foundation in Rio de Janeiro graciously offered the use of their excellent facilities. Ruy M. Paiva and Margaret H. Costa must be singled out for special thanks in this respect. Professors Elton Hinshaw and Werner Baer of Vanderbilt University also provided useful advice during my period of residence in Brazil. On a personal level, Professor and Mrs. Paulo Rónai were greatly appreciated for their unfailing aid in times of need.

In the United States, much help was given by my supervisory committee consisting of Professors Irving Goffman, Robert Bradbury, Ralph Blodgett and Richard Prêto-Rodas. Special thanks also go to Professor Eul-soo Pang of California State College at Hayward for his hospitality in Brazil and his extensive comments on Chapter IV. Finally, I would like to thank the Department of Economics, the Center for Latin American Studies and the NDEA program at the University of Florida for the financial aid which made the completion of this dissertation possible.

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KEY TO ABBREVIATIONS AND TERMS USED IN THE TEXT

Autarquia	Semiautonomous public institute operating at the national or state level
BNB	Banco do Nordeste do Brasil (Bank of the Northeast of Brazil)
BNDE	Banco Nacional do Desenvolvimento Econômico (National Development Bank)
CDPA	Comissaõ de Defesa da Produção Açucareira (Commission for the Defense of Sugar Production)
CEF	Centro de Estudos Fiscais (Financial Studies Center of the Getúlio Vargas Foundation)
CHESF	Companhia Hidroelétrica de São Francisco (São Francisco Hydroelectric Company)
CNC	Conselho Nacional do Café (National Coffee Council)
Companhia Mista	Semipublic corporate entity
Cruzeiro	Standard unit of Brazilian currency adopted in 1942
CVSF	Commisão do Vale do São Francisco (São Francisco Valley Commission)
DASP	Departamento Administrativo do Serviço Público (Administrative Department of the Public Service)
DNC	Departamento Nacional do Café (National Coffee Department)
DNOCS	Departamento National de Obras Contra as Sêcas (National Department of Works Against the Drought)

ECLA	United Nations Economic Commission for Latin America
ELECTROBRÁS	Government owned and operated electric power company
FGV	Fundação Getúlio Vargas (Getúlio Vargas Foundation)
IAA	Instituto do Açúcar e do Álcool (Sugar and Alcohol Institute)
IBGE	Instituto Brasileiro de Geografia e Estatística (Brazilian Institute of Geography and Statistics)
Milréis; Conto de Réis	Standard unit of Brazilian currency until 1942. A *conto de réis* was equivalent to one thousand *milréis*
Mineiro	A resident of the state of Minas Gerais
Paulista	A resident of the state of São Paulo
PETROBRÁS	Government owned and operated petroleum company
SALTE	Program of federal expenditures proposed in 1948. An acronym of the Portuguese words for health (*saúde*), food (*alimentação*), transportation (*transporte*) and energy (*energia*)
SPVEA	Superintendência do Plano de Valorização da Amazônia (Superintendency of the Plan for the Valorization of the Amazon Valley)
SUDENE	Superintendência do Desenvolvimento do Nordeste (Superintendency for the Development of the Northeast)
SUMOC	Superintendência da Moeda e Crédito (Superintendency of Money and Credit)

Abstract of Dissertation Presented to the Graduate Council
of the University of Florida in Partial Fulfillment of
the Requirements for the Degree of
Doctor of Philosophy

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June, 1970

Chairman: Irving J. Goffman
Major Department: Economics

The purpose of this dissertation is to describe and analyze the evolution of Brazilian fiscal federalism from 1889 to 1964. In doing so, the author emphasizes those factors which have been the prime contributing forces underlying changes in the basic federal-state-local financial relationships. A secondary purpose of the dissertation is to compare the Brazilian experience to those of other federations, both mature and emergent.

The method of analysis utilized is basically institutional, that is, it considers not only the economic aspects of the public sector, but also its political, cultural and social aspects. Substantial use is made of financial statistics obtained from both primary and secondary sources as well as literature in economics and related disciplines.

The dissertation is divided into eight chapters. Chapter I contains a survey of the past and present theories of fiscal federalism and a brief description of the finances of several non-Latin American federations. Chapter II describes and assesses the basis for federalism in Brazil with emphasis on the major forces for national unity and disunity. Chapter III outlines the constitutional and legal bases for Brazilian fiscal federalism through a description of the financial provisions of the four national constitutions and various laws in force during the period of study. Chapters IV through VII are concerned with describing and analyzing the changing nature of Brazilian fiscal federalism during four distinct periods of the nation's history. Chapter VIII contains a summary of the findings and some concluding comments.

Several major conclusions were reached by the author. The most basic of these was that Brazilian fiscal federalism has not been a static concept since its formation in 1889, but rather a pliable concept continually adapting to changing internal political, economic and social conditions as well as influences emanating from abroad. Another major conclusion was that significant changes in the nature of the federal finances before 1946 were almost inevitably associated with crises, namely, the two world

wars and the Great Depression. After 1946, the changes were almost entirely attributable to the postwar drive for accelerated national economic development.

Other conclusions concerned certain readily distinguishable tendencies of the Brazilian federal finances revealed during the 1889-1964 period. Among the most important of these were a marked growth of the public sector in absolute terms, and, relative to the national product, a centralization of public activity at the national level and a proliferation of public and semipublic entities operating at the national level but outside the regular federal budget.

INTRODUCTION

There is no shortage of material on the general topic of federal finance in the literature of economics and related disciplines. What is available, however, most certainly has a geographical and/or a cultural bias. Most of the books, monographs and articles on the subject are concerned with analyzing or describing some aspect of intergovernmental fiscal relationships in the "classical federations" of North America and Europe or in the "emerging federations" of Asia and Africa. This obvious bias is primarily a reflection of a long-standing interest of British or British-trained scholars and functionaries in the nature of federalism, both academically and as a practical solution to a nation's administrative problems.

The Latin American area has so far elicited very little scholarly attention in the field of public finance in general and the field of federal finance in particular. This may seem surprising since Mexico, Venezuela, Argentina and Brazil are all important Latin American countries which have adopted federal systems. The explanation of this apparent neglect can be traced in part to the relative scarcity of reliable economic and financial statistics and in part to the fact that none of them conform to the strict classical mold of federalism.

The purpose of the present dissertation is to examine the historical evolution of fiscal federalism in Brazil, the largest and most populous nation in Latin America. In doing so, an effort is made to emphasize both the uniqueness of the Brazilian experience and its similarity to other federalisms. Certain basic characteristics and tendencies of Brazilian fiscal federalism will thus be described and analyzed. Included among these are the social, cultural and political origins of Brazilian federalism, its constitutional and legal aspects, the question of centralization versus decentralization, the evolution of revenue and expenditure structures and the continual process of adjusting responsibilities to revenue sources among the various governmental levels and between given governmental levels in different regions of the country. The time period chosen for discussion, 1889 to 1964, coincides with the initial formation of federalism in Brazil to its most recent destruction in the aftermath of a military coup.

Although Brazil could never be characterized as a federation by the strict definition of the term and has only recently made available several types of important statistical data, these factors were not deemed sufficient causes for ignoring the topic. The first of these potential impediments was dismissed rather easily by the adoption of

a flexible working definition of the term "federalism."[1] The second potential difficulty, the lack of reliable statistics, proved more difficult to surmount. Social accounts and price indexes are largely a post-World War II phenomenon in Brazil and hence certain analyses and measurements are impossible to perform for the preceding periods. Fortunately, however, data on the budgetary finances of all levels of government are available for the whole period of the study. These statistics are probably quite reliable, but more detailed breakdown of revenue and expenditure categories would have been desirable in some circumstances.

The present dissertation is organized into eight chapters. The first two introduce the subject of federalism and assess its appropriateness to Brazil. Chapter III outlines the constitutional and legal aspects of Brazilian fiscal federalism by examining the financial provisions of the four constitutions and various decrees which were in effect between 1889 and 1964.

Chapters IV through VII constitute the main body of the study and follow a progression based on distinct historical periods. Close attention is given to the relationship between the constitutional and legal foundations

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[1]A discussion of the definition chosen for use in the present work is included in Chapter I.

of Brazilian fiscal federalism and its actual workings. The merits of such an approach were recognized in an early standard work on federal finance. B. P. Adarkar, writing in 1933, stated that it was "extremely difficult to infer, *a posteriori*, from the constitutional provisions, the actual day-to-day fiscal relations of the federal government and the states; these can only be understood with the help of the crystallised experience of fiscal practice."[2]

In describing the "crystallised experience" of Brazilian fiscal practice, the present author has made ample use of previously completed studies in disciplines often considered outside the economist's realm. Treatises in political science, history, sociology, anthropology and even linguistics were consulted in the writing of the present dissertation. Since these "noneconomic" variables at times challenged the "purely economic" variables in their importance to the public finances, even the most ardent "analytical" economists will probably find their use justifiable.

In the final chapter, the evolution of Brazilian fiscal federalism is discussed on the basis of the historical hindsight outlined in the preceding chapters. Emphasis is

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[2]B. P. Adarkar, *The Principles and Problems of Federal Finance* (London: P. S. King & Son, Ltd., 1933), p. 35.

on the major factors which have fostered its present state. In addition, comparisons are made between the Brazilian experience and the experiences of other federalisms, both mature and emergent.

A Note on the Brazilian Public Sector

Before proceeding, it is useful to clarify the concept of the public sector in Brazil, since in some ways it differs from that of the United States. In its barest form, the Brazilian public sector is three-tiered, being comprised of a national government, twenty-two states and some four thousand local governments called *municípios*.[3] Although the states are similar in juridical structure to the American states, the concept of "national" government and "local" government requires additional explanation.

The administrative unit with the widest territorial jurisdiction (referred to in the text as "national," "federal" or "union" government) is organized into a central authority which dispenses a wide range of functional responsibilities on a national scale and a number of smaller entities called *autarquias* or *companhias mistas* performing more specialized functions. The autarquias are semiautonomous institutes operating at the national level with their own

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[3]There are also three territories and a Federal District (the city of Brasília).

budgets, but receiving aid and subsidization in varying degrees from the central authority. Beginning their initial growth in the 1930's, their range of activity now spans many fields. Included among these are education and culture (the federal universities, for example), public utilities (federal railroads and shipping lines, for example), commodity control and regulation (coffee, sugar, alcohol and pine, for example), regional development, social security and others.

The third component of the public sector at the national level, the companhias mistas, are "mixed" semi-public enterprises of which the federal (or state) government often owns more than 90 per cent of the shares. Largely arising during World War II and the postwar years, they are also now engaged in many fields (petroleum, steel and banking, for example), but are generally characterized by greater budgetary and administrative independence than the autarquias. The companhias mistas are also claimed to operate in a more businesslike manner, since they must publish reports as separate corporate entities and are not subject to the laws governing the hiring and remuneration of public employees.[4]

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[4]Werner Baer, *Industrialization and Economic Development in Brazil* (Homewood, Ill.: Richard D. Irwin, Inc., 1965), pp. 94-95.

The município (loosely translated in the text as "municipality") is the basic unit of local government in Brazil. In contrast to the North American municipality, the município is not an incorporated town or city but something which more resembles our county. Like North American counties, the Brazilian município is divided into two distinct parts, the seat (*sede*) and some surrounding territory. In contrast to the general American practice, however, the seat of a município is never incorporated. In further contrast to the common administrative arrangement in the United States, a prerequisite to the division of a município into a smaller unit (*distrito de paz*) is the existence of a population and/or commercial center (called a *vila*) separate from the sede of a município. An additional feature is that the seat of a município always has the same name as the município and the vila of a distrito de paz always has the same name as the distrito de paz.[5]

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[5]T. Lynn Smith, *Brazil: People and Institutions* (rev. ed.; Baton Rouge: Louisiana State University Press, 1963), pp. 569-70.

CHAPTER I

THE THEORY AND PRACTICE OF FISCAL FEDERALISM

It is the purpose of the present chapter to outline some of the salient features of federal finance. A comprehensive study of the topic is far beyond the scope of this dissertation, but it is felt that a summary of its more important aspects will serve to elucidate the ensuing discussion of the Brazilian experience. The method of presentation will be both theoretical and empirical. The theoretical part deals with the general nature of federalism with emphasis on its fiscal aspects. Empirical examples will be interspersed with the theoretical presentation in an attempt to show the variety of experiences among the principal federal nations of the world in dealing with the special problems of federal finance.[1] Through these examples it is hoped that the reader will appreciate the fact that the terms "federalism" and "fiscal federalism" are by no means unambiguous concepts and may vary considerably in meaning between countries and through time.

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[1]The United States, Canada, Australia and the Commonwealth federations formed after World War II will be employed as the primary examples.

The Federal Principle

An immediate problem which arises in dealing with federalism is deciding upon a suitable definition for the term itself in light of the fact that its interpretation may vary from country to country and from time period to time period. K. C. Wheare, in his standard work on federal government, differentiates a federation from other types of associations in that the former embodies what he terms the "federal principle." The "federal principle" is defined as "the method of dividing powers so that the general and regional governments are each, within a sphere, coordinate and independent."[2] William S. Livingston offers a more general definition: "Federal government is a form of political and constitutional organization that unites into a single polity a number of diversified groups or component polities so that the personality and individuality of the component parts are largely preserved while creating in the new totality a separate and distinct political and constitutional unit."[3]

Each of these definitions basically implies that the two or more levels of government in a federation will

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[2]K. C. Wheare, *Federal Government* (4th ed.; New York: Oxford University Press, 1964), p. 10. Wheare uses the term "general government" to denote the central unit and the term "regional governments" to denote the state (provincial) and local units.

[3]William S. Livingston, *Federalism and Constitutional Change* (London: Oxford University Press, 1956), p. 9.

be called upon to perform functions within a prescribed field. Wheare's strict definition, however, holds that these areas of responsibility should be independent, while Livingston's seems to allow for some overlapping. In addition, there is an assumption, implicit in the first definition and explicit in the second, that a desire for unity and for diversity exists side by side within a given geographical area. The division of responsibilities between the central and state-local governments is thus a response to the demands of those persons wishing services providing benefits on a national scale and those persons (the same group) demanding public services whose benefits extend to a more locally defined area.

The formal division of powers between the center and the state-local units is normally contained in a written constitution which "will be more or less federal in accordance with the relative strength of the two demands," that is, the demand for unity and the demand for diversity.[4] The demand for union may be the result of a widespread desire for increased military strength, economic advantage or other factors such as a common language or nationality. The desire for the preservation of diversity, on the other hand, may emanate from geographically dispersed differences in wealth, culture, race and historical backgrounds.

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[4]William S. Livingston, "A Note on the Nature of Federalism," *Political Science Quarterly*, LXVII, No. 1 (1952), 90.

In addition to a written constitution and a formal distribution of powers, Livingston lists four other instrumentalities usually found to be essential in federal systems. They are constitutional interpretation (commonly by the judiciary), state representation in the legislature, dual citizenship (national and state) and the federal executive.[5]

Federalism as a Process

A requisite of a successful federalism is adaptability. This view is held by Carl J. Friedrich who prefers to see federalism as a process and not as a static, legalistic concept.[6] Since social, economic and political conditions are constantly changing, it follows that "any federal relationship requires effective and built-in arrangements through which [the] rules can be recurrently changed upon the initiative and consent of the federated entities."[7]

The method through which this change is manifested differs between nations. Alterations in the federal relationship may come about through formal amendment to the constitution, an act of the legislature, judicial review

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[5]Livingston, *Constitutional Change*, pp. 10-11.

[6]Carl J. Friedrich, *Trends of Federalism in Theory and Practice* (New York: Frederick A. Praeger, 1968).

[7]*Ibid.*, p. 173.

or simply through changes in customary practices. Livingston states that "the formal procedure of amendment is of greater importance than the informal processes because it constitutes a higher authority to which appeal lies on any question that may arise."[8] Constitutional amendment, though, is often a cumbersome process and there is no consensus of opinion as to how it should ideally be carried out. A minimum requirement generally agreed upon is that the constitution may not be changed without the consent of both the general and regional governments. If either the national government or the state governments could amend the constitution by itself, a true federal system would probably no longer exist.

The Direction of Change

The "classical" federations of the United States, Canada, Australia and Switzerland have adapted to a changing environment in different ways. While judicial interpretation of the constitution has been an important factor in the first three of these countries, it has been less significant in the fourth. Switzerland has made relatively greater use of the formal amendment than has either the United States or Australia. The Canadian constitution contains no provision for amending itself and, as a result, governmental change

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[8]Livingston, *Constitutional Change*, p. 13.

in this nation has largely come about through "evolving habits and customs, new conventions replacing old."[9]

One common feature of these older federations is that the direction of their governmental change has been toward centralization. This trend has generally been a reaction to the combined influences of war, economic depression and the emergence of the welfare state.[10] Alan T. Peacock and Jack Wiseman make note of this tendency in their study of public expenditure growth in the United Kingdom and term it the "concentration process."[11] While recognizing the centralizing pressures brought about by war, depression and the welfare state, these authors hypothesize that there are certain factors associated with economic growth which produce the same effect. Most important among these factors are improvements in transportation and communication. Such improvements encourage the centralization of public responsibility by generating demands for

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[9] *Ibid.*

[10] F. G. Carnell, "Political Implications of Federalism in New States," in U. K. Hicks *et al.*, *Federalism and Economic Growth in Underdeveloped Countries* (New York: Oxford University Press, 1961), p. 17.

[11] Alan T. Peacock and Jack Wiseman, *The Growth of Public Expenditure in the United Kingdom* (Princeton: Princeton University Press, 1961), pp. 29-30. Although originally devised to describe the experience of a unitary country, the concept of the "concentration process" would seem to be equally applicable to a federation.

uniformity of service standards and by allowing a larger unit of government to be more efficient in carrying out certain functions.

William H. Riker submits that increasing centralization is essential to the very survival of a federal nation.[12] He contends that the demise of an initially "peripheralized" federalism (where most powers are allocated to the regional units) is almost certain since there is a tendency for the component governments to increase their powers to the point where their union disintegrates. This disintegration weakens them militarily and hence makes them easy prey for their enemies.[13] Initially centralized federations, like the United States, tend to be more durable. The national government of such nations will commonly make use of its originally superior power to acquire still more power over time. The union thus grows stronger and is better able to cope with those forces, from within and without, which seek to destroy the system.

In the newer federations, an additional force for centralization is the drive for economic development.

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[12]William H. Riker, *Federalism: Origin, Operation, Significance* (Boston: Little, Brown and Company, 1964), *passim*.

[13]The examples of the city-states of ancient Greece and the military federations of medieval Italy and Germany are cited as proof of this hypothesis. Riker, *Federalism*, p. 8.

Often making use of national economic and social planning to reach this goal, the developing nation finds that the federal government must play an increasingly larger role. At the same time, however, there are usually strong divisive tendencies in these countries emanating from various political and social factors. Cultural, religious and ethnic differences and the rapidity of political change are generally greater in the newer federations as compared to the nineteenth century federations at the time of their inception.[14] Hence it is difficult to generalize about the "net" direction of change in the newer federations. In India the centralizing forces (national economic planning being one of them) have predominated while in Nigeria we find the opposite situation.

The Major Problems of Federal Finance

All nations, whether federal or unitary, must make some provision for the financing of the services they choose to undertake. In a completely unitary country all political and fiscal power rests at the center. Although the local units of government may generally impose laws, regulations and taxes on the individual citizens, they do so only as "agents" of the central government. Intergovernmental fiscal relations in a unitary nation are thus

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[14]U. K. Hicks, "Epilogue," in U. K. Hicks *et al.*, *Federalism and Economic Growth*, pp. 153-54.

simplified since the central government alone decides what public functions are to be carried out as well as the method of financing them.[15]

In a federation, matters are complicated by the fact that independent political and fiscal authority is divided between two or more levels of government. Following Wheare's strict definition of a federation, though, there is no federal-state-local fiscal problem. This is because total adherence to the "federal principle" requires that revenue sources be divided among the several levels of government so that each will enjoy sufficient resources to carry out its exclusive functions. Fiscal difficulties do arise in reality because Wheare's "ideal" case rarely (if ever) exists. *The basic problem of federal finance is the imperfect matching of allocated revenue sources and allocated functions.* A multitude of subsidiary problems emanate from this basic one, since every federal nation must face the inevitable task of adjusting public responsibilities to available resources. The following discussion

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[15]In unitary nations where significant financial and political autonomy exists at the local level, however, intergovernmental relationships may become very complex. See, for example, Alan Williams, "Centralization and Decentralization in Public Finance with Special Reference to Central and Local Government in England and Wales," in U. S., Congress, Joint Economic Committee, *Revenue Sharing and Its Alternatives: What Future for Fiscal Federalism?* Joint Committee Print, 3 vols. (Washington, D. C.: Government Printing Office, 1967), I, 592-623.

seeks to analyze this question from both a theoretical and empirical viewpoint.

Lack of Correlation Between Functions and Revenue Sources

A discussion of the basic problem involves a more thorough study of a matter previously mentioned. This is the question of what should be the principles governing the division of functions to be performed by the national, state and local units and what should be the principles governing the division of revenue sources among these levels. Both questions have political and economic aspects.

Distribution of Functions

Theory

With respect to the allocation of functions, James M. Buchanan states in a general sense that "the *economic or efficient division* of responsibility among the separate levels of government depends upon the geographical range of the spillover effects of collective action" (italics added).[16] In other words, the division of functions among the various levels of government should be made in accordance with the spatial distance over which the benefits of these functions spread. Using this criterion, one could

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[16]James M. Buchanan, *The Public Finances* (rev. ed.; Homewood Ill.: Richard D. Irwin, Inc., 1963), p. 504.

justify federal jurisdiction over defense and foreign policy (where the benefits are national in scope) and state and/or municipal jurisdiction over local recreational facilities (where the benefits are more locally confined).

An important qualification is attached to the above generalization. This reservation stems from the fact that the benefits from some public services, although accruing primarily to a local area, do effect people in other regions. Education is a prime example of this type of service. Its benefits are of greatest interest to the citizens of the community in which the school is situated, but they also effect, to a greater or lesser degree, the state, region or nation. Transportation facilities, such as roads and airports, and some health facilities exhibit similar qualities.

The paramount question, then, is which governmental functions are in the national interest and which are in the state-local interest? The answer is that many services fall into both categories. This quandary has prompted Buchanan to note that in the United States "the extent of the national interest, that is, the interest of the whole population, in particular public services performed traditionally by state-local units, looms as one of the most important problems in the current stage of federal-state relationships."[17]

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[17] *Ibid.*, p. 509.

A consideration of importance in this respect concerns the size of the governmental unit needed to obtain economies of large-scale production in performing various functions. Obviously, all public services do not obtain these economies at the same level of government. Whereas defense, foreign affairs and monetary and fiscal policy reach full economies of scale only at the national level, such services as education, courts and fire and police protection can be efficiently provided locally.[18] Some services, such as transportation facilities, may be performed at the local level but reach full efficiency only when coordinated with the systems of other communities.[19] This is not to say, however, that delegating a certain responsibility to a larger unit of government will necessarily produce economies. Large governmental units often experience the same problems as large industrial firms like red tape and lack of communication. Such factors may produce diseconomies of scale which may wholly or partially negate any increases in efficiency resulting from large-scale

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[18]For a brief survey of this general topic see: Harvey Shapiro, "Economies of Scale and Local Government Finance," *Land Economics* (May, 1963), pp. 175-86.

[19]Such coordination, however, is not always the best policy since "on the usual economic welfare grounds, municipal integration is justified only if more of any service is forthcoming at the same total cost and without reduction of any other service." Charles M. Tiebout, "A Pure Theory of Local Expenditures," *Journal of Political Economy*, LXIV, No. 5 (1956), 423.

production of the particular service. Hence, it is usually the best policy to allocate the responsibility of performing a given function to the smallest unit capable of efficiently carrying it out.[20]

The division of functional authority among the levels of government in a federation is further complicated by political factors; the primary one being that the state boundaries are normally drawn according to political and/or historical guidelines which rarely coincide with economic realities. As a result, inefficiencies and duplication are common as given states attempt to confine the benefits of their services to their own politically defined areas. When interstate migration is pronounced, the standard of public services may be lower than might otherwise be the case. This is because those in the state experiencing the outflow of population might feel that they are subsidizing the states receiving the inflow. This aspect would seem to be most relevant with respect to expenditures on education.[21]

Some problems calling for public action comprise a geographical area which does not conform to political boundaries. A nation, for example, may contain one or

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[20]John F. Due, *Government Finance* (3rd ed.; Homewood, Ill.: Richard D. Irwin, Inc., 1963), p. 437.

[21]An interesting discussion of this problem can be found in: Burton A. Weisbrod, *External Benefits of Public Education: An Economic Analysis* (Princeton: Industrial Relations Section, Princeton University, 1964).

more chronically depressed regions which deserve special attention. The Appalachian area of the United States and the "drought polygon" of Brazil are cases in point. In addition, a region may support an industry, the regulation or control of which is vital to the interests of the states involved. The petroleum industry of the American Southwest may be cited in this respect. Similar difficulties arise in the control of interstate crime and the supervision of the use of ports, rivers and lakes which serve the needs of several states. The port of New York and the Columbia and Ohio River basins are examples of the latter. Also, the provision of special forms of public services may be needed by ethnic groups (Negroes, Mexican-Americans and Indians in the United States) whose patterns of settlement encompass many states or regions.

Practice

In the major federations of the world, the guidelines for the division of responsibilities outlined above have been roughly followed. Such functions as national defense and foreign affairs have generally been the sole responsibility of the national government, while police and fire protection have been provided by local governments. Few public services, however, have been independently supplied by one level of government.[22] This has been especially true with respect

[22]This tendency has prompted one writer to compare (in reference to the United States) the federal system to a marble cake rather than a three-layered cake.

to the "social services" (including education, health, welfare and related fields). Since the shift in administrative jurisdiction over these services from the state-local units to cooperation among all three units has been a singularly important step in the development of modern fiscal federalism, a detailed discussion of this trend has been included below.

The constitutions of the United States, Canada, Australia and India (in their original forms) generally empowered the regional governments to legislate on matters pertaining to the social services.[23] In all cases, however, the national government has increased its role in this field through constitutional amendment, judicial interpretation and/or grants-in-aid to the states and municipalities. This administrative centralization has been partially a result of the inherent characteristics of the social services; they are costly and national uniformity is commonly desired in their provision. Revised public opinion toward the concept of the "welfare state" has also been an important contributing factor. The final result has been for all levels of government to enter into the provision of social services to a greater or lesser degree.

Education.—Education has traditionally been a joint responsibility of state and local authorities. The

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[23]Wheare, *Federal Government*, pp. 145-46.

propriety of state and local jurisdiction over education is perhaps most clear in countries like Canada and Switzerland where significant religious and/or language diversities exist. In Switzerland, the constitution does not guarantee the right to have denominational schools, but in practice the cantons have been quite tolerant in this respect. Most cantons offer both state and denominational facilities.[24] Canada has experienced somewhat greater difficulties. Although apparently maintaining the right of the provinces to provide separate denominational schools if they existed before federation, the Canadian constitution is unclear as to whether the provinces not among those in the original federation should be included. As a result, controversy arose over this question when Manitoba, Saskatchewan and Alberta were admitted as provinces. By and large, these difficulties were alleviated through compromise; Manitoba, for example, was allowed to provide religious training in state schools.[25]

In the United States, the provision of public education remains overwhelmingly local, although the expansion of higher educational facilities has increased the role of the states. In 1962, local governments accounted for 78 per cent of total direct spending on education, with

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[24] *Ibid.*, p. 154.

[25] *Ibid.*

the states and federal government spending 19 per cent and 3 per cent respectively.[26] These percentages obscure the fact, however, that the federal government's grants-in-aid earmarked for education amounted to 15 per cent of the $7 billion in total grants paid in that year.[27] The federal government has also assisted education through granting scholarships, subsidizing research, the school lunch program and such activities as the Job Corps and Head Start. It has also enforced national legislation in the schools pertaining to civil rights and religious training.

The Indian constitution reserves the power to legislate on education, including the university level, to the states. The federal government, though, retains jurisdiction over certain universities and types of training deemed to be of "national importance."[28] The Union assists the states by grants-in-aid and coordinates the resources devoted to education in the National Plans.[29]

Health.—The area of health services has generally been a state, local or private responsibility. In virtually

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[26]Frederick C. Mosher and Orville F. Poland, *The Costs of American Governments: Facts, Trends, Myths* (New York: Dodd, Mead & Company, 1964), p. 46.

[27]*Ibid.*, p. 53.

[28]B. M. Sharma and L. P. Choudry, *Federal Polity* (New York: Asia Publishing House, 1967), pp. 216 and 227.

[29]Asok Chanda, *Federalism in India: A Study of Union-State Relations* (London: George Allen & Unwin Ltd., 1965), pp. 288-92.

all federations, however, the national government has aided by sponsoring medical research, offering health insurance programs, passing pure food and drug acts, providing veterans' benefits and controlling the international aspects of health.

In the United States, the trend has been for the federal government to increase its role in the field of health and hospitals. Between 1927 and 1962, this level of government increased its relative share in the total public sector in this functional category from 18 to 29 per cent.[30] The growth of federal responsibility has been primarily the result of increased spending on veterans' hospital services and the subsidization of medical research through the National Institutes of Health.[31] The provision of a comprehensive system of national medical insurance has yet to be enacted, although in 1965 medical care for the aged (MEDICARE) was offered through the social security program.

Canada and Australia have also experienced a tendency for the federal government to enter the field of health. In both countries, this trend has generally been a postwar phenomenon, since before World War II the prime responsibility for this service rested with the

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[30]Mosher and Poland, *American Governments*, p. 47.

[31]*Ibid.*, pp. 124-25.

regional governments and/or the private sector (although a portion of the unconditional federal-state [provincial] grants was undoubtedly used for health services).[32] In Canada, the Dominion has been subsidizing provincial health activities since 1948 (mainly in hospital construction) and in 1957 a national health insurance system was enacted which is financed on a joint Dominion-provincial basis.[33]

The basis for the entrance of the Australian federal government into the health field was the constitutional amendment of 1946 which enabled the Commonwealth parliament to legislate in the area of the social services.[34] This amendment was necessary because the constitution had originally allocated only the power to legislate with respect to "invalid and old age pensions" to the Commonwealth government.[35] An Unemployment and Sickness Benefits Bill, a Pharmaceutical Benefits Bill, a Hospital Benefits Bill and a Tuberculosis Bill were enacted in 1944 and 1945,

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[32]A. H. Birch, *Federalism, Finance and Social Legislation in Canada, Australia and the United States* (London: Oxford University Press, 1955), *passim*.

[33]Irving J. Goffman, *Some Fiscal Aspects of Public Welfare in Canada*, Queen's University Papers in Taxation and Public Finance, No. 1 (Toronto: Canadian Tax Foundation, 1965), p. 26.

[34]Birch, *Social Legislation*, p. 234.

[35]The Australian constitution, like that of the United States, reserves residuary powers to the states.

but their constitutionality had been in doubt.[36] The 1946 amendment solved these legal problems and made possible the National Health Service Act of 1948, a piece of legislation which greatly expanded Commonwealth powers in the provision of public medical and dental services.[37] At present, the federal government provides a medical benefits scheme, a hospital benefits scheme, a pensioner medical service, pharmaceutical benefits and pharmaceutical benefits to pensioners.[38] In addition, there are Commonwealth subsidies for combatting tuberculosis and polio and grants-in-aid to the states for the construction and improvement of mental hospitals.[39]

In Switzerland, the national government has also extended its powers to legislate in the social sphere through constitutional change; the Constitution of 1848 had originally allocated only the powers to conduct a federal university and a federal polytechnic school. Referenda passed in 1890, 1897 and 1913 empowered the Swiss federal government to deal with accident and sickness insurance, regulate the sale of foods and deal with contagious and

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[36]Birch, *Social Legislation*, pp. 230-34.

[37]*Ibid.*, pp. 261-67.

[38]Australia, Department of the Interior, *Official Handbook—1962* (Canberra, 1962), pp. 76-79.

[39]*Ibid.*, pp. 73-76.

infectious diseases and epidemics.[40] This country was a pioneer in the field of medical insurance, having had a compulsory and voluntary accident insurance plan and a voluntary sickness insurance plan since 1911. The former is operated as a federal monopoly and the latter is the responsibility of nonprofit insurance agencies, although both may receive federal subsidies.[41]

Article 246 of the Indian constitution gives the states exclusive power to legislate on the matter of "public health, sanitation, hospitals and dispensaries."[42] Once again, however, the central government has provided assistance to the lower governmental units. A Central Council of Health "deals with all questions of health such a co-ordinated nation-wide campaign[s] for the eradication of malaria and other diseases prevalent throughout the country" and "is also responsible for recommending the distribution of grants-in-aid for health purposes."[43]

Welfare.—The area of public welfare encompasses such functions as the alleviation of poverty, unemployment compensation, old-age and invalid pensions, maternity

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[40]Wheare, *Federal Government*, p. 147.

[41]George A. Codding, *The Federal Government of Switzerland* (Boston: Houghton Mifflin Company, 1961), p. 146.

[42]Sharma and Choudry, *Federal Polity*, p. 255.

[43]Chanda, *Federalism in India*, pp. 110-11.

allowances and the like. As a rule, these services are very costly to provide and are thus reserved mainly for wealthy countries. The United States, Canada, Australia and Switzerland have fairly developed public programs in this area, while in India they are almost totally lacking. It is interesting to note, however, that the emergence of national welfare programs in the four older federations has been a fairly recent occurrence, especially in Canada.

In these older federal nations, a primary stimulus to the national provision of welfare programs was the worldwide depression of the 1930's. During this period the need for such services rose rapidly at the same time state and local finances were declining. The respective federal governments were called upon to fill the vacuum since they generally possessed the most lucrative sources of revenue and were better able to engage in deficit financing. While the federal government of the United States responded to the crisis immediately with comprehensive new legislation, the respective federal governments of Canada, Australia and Switzerland played somewhat lesser roles.

The state of social welfare services in the United States before the depression is described by A. H. Birch.[44]

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[44]Birch, *Social Legislation*, p. 27.

> Poverty arising from unemployment was dealt with by private charity and by state poor laws of the Elizabethan type, together with poverty arising from old age, physical disabilities, and other causes. Responsibility for the relief of such poverty rested with the municipalities and rural local authorities. There were no old-age pensions, maternity benefits, child allowances, or health insurance schemes. The state governments organized employment services, but they varied greatly in efficiency and there was no interstate service.

This situation changed, however, as widespread economic hardship placed extreme demands on local welfare agencies. As a result, local governments quickly exhausted their relief funds and turned to the states for aid. The states attempted to fill the gap, but were in turn forced to seek assistance from the federal government. President Roosevelt responded to this plea by creating the Federal Emergency Relief Administration in 1933. This body was empowered to make grants to the states to cover their resource deficiencies in dealing with relief problems. In 1935, the federal government withdrew these types of grants and sought to counter unemployment through the Works Progress Administration. In the same year, the Social Security Act was passed (to go into effect in 1937), a piece of legislation which was to form the basis for much of the national welfare schemes which followed.[45]

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[45]U. S., Department of Health, Education, and Welfare, Social Security Administration, *Social Security Programs in the United States* (Washington, D. C.: Government Printing Office, 1966), pp. 5-6.

Originally the Social Security Act was to provide for old-age and survivors insurance and unemployment compensation, but subsequent revisions have included disability benefits (1957) and medical care for the aged (1965). The Act also provided for grants-in-aid from the federal government to the states to support the needy aged, blind, widowed and orphaned, physically and mentally handicapped, maternal and child health services, services for crippled children and child welfare services.[46] These grants were to be administered by the states and often required that they provide matching funds.[47] The Economic Opportunity Act of 1964, the basis of a fairly comprehensive "War on Poverty," is acting to expand and supplement existing public assistance programs.

In Canada, the hardships of the depression did not produce a national commitment to provide welfare services anywhere near the level experienced in the United States. Burdened with constitutional problems and the tradition of provincial-municipal jurisdiction over public assistance programs, the Dominion Parliament did not enact a single piece of permanent legislation in this area during the

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[46] *Ibid.*, p. iii.

[47] The state and local governments also continued to provide independently financed and administered social welfare services including workmen's compensation programs.

1930 to 1940 period. During these years, federal aid to the states for the support of relief works, single homeless men, unemployed workers, Western farmers and youth was embodied in eleven temporary arrangements.[48]

During World War II, some social legislation was enacted, including the Unemployment Insurance Act of 1940 (which required a constitutional amendment) and the Family Allowance Act of 1944. Although undoubtedly representing a change in public opinion concerning the merits of the "welfare state," this wartime legislation was also influenced by the implications of J. M. Keynes' writings.[49] It was only in the postwar years that the Canadian people appeared to fully embrace the concept of the "welfare state." In 1951, an amendment was added to the Canadian constitution which empowered the Dominion to legislate concerning old-age pensions and such a program was put into effect in the following year. Four years later, in 1956, legislation was passed which provided for federal assistance to the provinces for the unemployed and unemployables. In addition to the provision of a national hospital insurance scheme mentioned previously, recent legislation also includes a revised and improved federal old age pension plan.[50]

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[48]Goffman, *Public Welfare*, p. 22.

[49]*Ibid.*, p. 24.

[50]The new scheme provides for uniform benefits and contributions and is completely portable throughout the country. *Ibid.*, p. 27, n. 48.

The federal governments of Australia and Switzerland entered the field of social assistance before those of the United States and Canada. By 1912, the Australian Parliament had enacted old-age pensions, invalid pensions and maternity allowances.[51] The Swiss constitution as early as 1890 had been amended to allow for a federally supervised program of sickness and accident insurance. Both nations, however, left the relief problems emanating from the depression to the states (cantons), although federal grants-in-aid were commonly employed to alleviate some of the financial problems of these component units.[52] As in Canada, however, the experience of the depression apparently fostered greater public acceptance of the "welfare state" in these two countries. This is evidenced by the legislation creating the Swiss Old Age and Survivors Insurance Act of 1946 and the amendment to the Australian constitution in the same year, which made possible a greatly expanded role of the federal government in social affairs. Since 1946, Commonwealth legislation in the social services field has expanded to include rehabilitation service (1948) and child endowment (1950).[53]

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[51]Birch, *Social Legislation*, pp. 205-06.

[52]Wheare, *Federal Government*, pp. 150 and 158.

[53]Australia, *Official Handbook*, p. 67.

In the foregoing discussion, it has been indicated that the nature of the functional division of responsibilities among the component units of a federation has been changing in recent decades. While some services generally continue to be performed by one level of government or another, it can be noted that more and more are being carried out on a cooperative basis. Although the experience of the principal federations in dealing with the provision of social services was selected for more intensive analysis, the same tendencies can be noted to a greater or lesser degree in such areas as natural resource conservation and highway construction among others. The same tendency toward intergovernmental cooperation can also be noted with respect to the financing of these various public services. It is to this general topic that the discussion now turns.

Distribution of Revenue Sources

Besides deciding upon a suitable distribution of functions, a federation must confront the problem of allocating revenue sources. These sources may be of many types including taxation, borrowing, monopolies and commercial undertakings. Since the latter two revenues are generally of little relative consequence, only the principles governing the first two will be outlined.

Theory

Taxation—As with the divison of functions between governmental units, there is no one principle guiding the apportionment of tax sources. It is clear, though, that certain taxes may be more efficiently imposed and collected by one level of government than by another. As a general rule, "most taxes can be collected with the highest degree of effectiveness by the federal government, while very few can be administered in even a tolerable fashion by the local governments. The states occupy an intermediate position."[54] The validity of this statement stems from the fact that the national government has jurisdiction over the largest territorial division of the tax base and because centralized collection of taxes often involves economies of scale.

Having a large territorial jurisdiction is crucial in a federation because of the possibilities of tax base migration. When taxation in a given state, county or city is unusually high, persons may well be persuaded to move to a different geographical area. Taxes imposed by the federal government are not so easily escaped (unless one desires to relinquish his national citizenship). Furthermore, the federal government is generally better equipped

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[54]Due, *Government Finance*, p. 438.

to monitor the tax liabilities of those persons owning property, receiving income, making purchases, etc., in several states and/or communities. Hence tax evasion may be better controlled.

One principle with which there is general agreement concerns the fiscal aspects of interstate and/or intercommunity commerce.[55] Since one of the advantages of a federation is the enlargement of markets (with the accompanying benefits of specialization), it follows that taxes which may tend to impede internal trade should be prohibited or at least used in moderation. In the area of international trade, a coordinated national tariff usually requires that the central government control the levying of customs duties.

Borrowing—The problems of borrowing in a federation are essentially twofold.[56] First there is the problem of deciding upon suitable constitutional provisions regarding the borrowing powers of the federal, state and local governments. Secondly, agreement must be reached concerning administrative control and coordination of these borrowing powers.

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[55]See, for example, B. P. Adarkar, *Federal Finance*, pp. 43-44 and Geoffrey Sawer, "Taxation in a Federation," in *Federalism and the New Nations of Africa*, ed. by David P. Currie (Chicago: University of Chicago Press, 1964), p. 263.

[56]Adarkar, *Federal Finance*, pp. 266-75.

The first question has several ramifications. According to B. P. Adarkar, the constitutional provisions pertaining to public borrowing "may be classed under three heads: (a) those relating to borrowing powers themselves; (b) those relating to federal assumption of prefederation state debts; and (c) those relating to concerted control."[57] A federal form of government complicates these basic decisions. This is because the writers of the constitution must contend with the (possibly conflicting) desires of two or more independent administrative levels.[58] When the propensities to borrow these component units are widely divergent, the second problem mentioned above (administrative control and coordination) may become insoluble. In a situation where state and local governments borrow in foreign markets, severe difficulties may arise, especially if the debtor units default on their interest and amortization commitments. If this latter situation occurs, repercussions of an international nature may cause embarrassment to the federal government, since the lower administrative units do not normally have the authority to deal in the area of foreign affairs.

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[57] *Ibid.*, p. 266.

[58] In a unitary nation such problems do not arise since the central government is customarily allocated the exclusive power to borrow.

Although a federal constitution may allow for unlimited borrowing at all levels of government, all levels may not, in reality, have an equal opportunity to sell debt. In most cases the central authority will have an advantage over the state and local units. Due to its larger collateral base, the federal government may be in a better position to offer more attractive terms to potential investors. Legal provisions such as federal guarantees of state and local debts and exemptions from federal taxes on income emanating from this debt, however, may partially or wholly offset any advantages held by the federal government.

Practice

The "old" federations—Considerable similarity may be noted in the original constitutional division of tax sources between levels of government in the "older" federations (the United States, Canada, Australia and Switzerland).[59] As a general rule, the distribution of tax jurisdictions in this group of countries was characterized by few allocations of exclusive revenue sources to the respective federal and state-local units. In order to maximize the benefits of economic union, the constitutions

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[59]The United States adopted the federal form of government in 1787, while Canada, Australia and Switzerland took their present forms in 1867, 1900 and 1848, respectively.

of the older federations reserved the collection of customs and excises for the exclusive use of the national government; the other taxes generally being left to concurrent jurisdiction. Since customs and excises represented the most lucrative sources of revenue at the time, the federal governments of these nations generally started out with an adequate financial base. The relative balance of financial power between the national government and the state-local units, though, varied among the four countries.

The fiscal power resulting from these original constitutional provisions was especially favorable to the central government in Canada. In that country, the British North America Act of 1867 empowered the Dominion to raise revenue through any "mode or system of taxation."[60] The provinces were only allowed to collect direct taxes "within the province in order to the raising of a revenue for provincial purposes"[61] and "shop, saloon, tavern, auctioneer, and other licenses in order to the raising of a revenue for provincial, local or municipal purposes."[62] As a result of these provisions, the Canadian federal government initially absorbed virtually all of the productive tax sources.[63]

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[60]Sec. 91 (3).

[61]Sec. 92 (2).

[62]Sec. 92 (9).

[63]Dominion control over customs and excises was a particularly severe loss to the provinces, since before federation some of them, like Nova Scotia, were receiving over 80 per cent of their total revenues from these taxes. Birch, *Social Legislation*, p. 80.

At the other end of the spectrum was Switzerland; the United States and Australia were somewhere in between. In the Swiss Constitution of 1848 the federal government was empowered to collect only customs duties, the remaining tax sphere being reserved to the cantons.[64] Ostensibly the cantons were given the widest range of tax sources to finance their activities. In reality, however, customs duties represented a very important source of income and were able to provide a sufficient level of income to the federal government until World War I.

Provisions allowing for both federal and state-local borrowing were included in the constitutions of all four nations. In addition, state debts were assumed by the national government almost immediately after federation in the United States and Canada.[65] They were also assumed by the Australian federal government, but only after three decades of nationhood had elapsed.[66]

Any problems which might have arisen as a result of the financial arrangements in the older federations were minimized by the fact that they were formed during an era of laissez faire. With the public sector performing only

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[64]Wheare, *Federal Government*, p. 103.

[65]James A. Maxwell, *The Fiscal Impact of Federalism in the United States* (Cambridge: Harvard University Press, 1946), pp. 8-9 and Birch, *Social Legislation*, pp. 54-56.

[66]Birch, *Social Legislation*, pp. 112-14.

a meager number of services, the need for revenues was consequently low. The same factors which created a greater demand for public services (war, depression and the welfare state), however, also made increased revenues necessary.

A lasting influence on the tax systems in all four federations was World War I. Up to this time relatively adequate financing had been forthcoming at all levels of government. The central governments of these countries had been receiving large revenues from customs duties and often enjoyed large budgetary surpluses. The state-local governments, on the other hand, were generally able to carry out their responsibilities through their own tax sources plus grants-in-aid from the federal government.[67]

During World War I, mounting costs at the federal level came just at the time revenues from customs were falling. The consequent financial need obliged the national governments in all four federations to seek new revenue sources. A solution to this problem was thought to lie in the area of direct taxation. As a result, the United States, Canada, Australia and Switzerland made extensive use of the income tax in the war years, with the national governments of the latter three nations entering this field for the

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[67]Revenue transfers from the national government to the states were much less prevalent in the United States than in the other three older federations, largely because of the American states' superior ability to exploit their constitutionally allocated tax sources (especially property taxes).

first time.[68] When the war was over these taxes remained important and growing sources of federal revenue; this tendency for the national governments to increasingly enter the field of direct taxation proceeded to alter the near complete separation of tax sources which existed before the war.

The federal encroachment into the areas of taxation traditionally reserved to the states coincided with increased public demands for services customarily performed by the state-local units. This problem was clearly brought out in the depression of the 1930's. The cooperation among the levels of government in carrying out certain functions (especially the social services) during these years was, by necessity, extended to financial cooperation. The two methods most commonly employed to secure this cooperation were tax sharing and grants-in-aid (both voluntary and obligatory). All four federations, however, did not make equal use of these methods.

Although both the American and Swiss federal governments made extensive use of voluntary grants for transferring funds to the states, only the latter nation employed tax sharing. In Canada and Australia, obligatory subsidies from the federal government to the states had been included in their respective constitutions and,

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[68]Wheare, *Federal Government*, pp. 103-04.

supplemented by voluntary grants, remained as the most important method of intergovernmental fiscal cooperation in those countries.[69] Voluntary grants, potentially the most flexible type of federal aid to the states, increased in all four federations during the depression. By 1939, they comprised 15 per cent of total state income in the United States, 10 per cent in Canada, 12 per cent in Australia and 25 per cent in Switzerland.[70]

This increased financial cooperation during the 1930's had apparently implanted itself since it continued during World War II and into the postwar years. During the war years the use of grants from the federal government to the states was especially significant in Australia and Canada. In those countries, the financial demands generated by large defense expenditures necessitated arrangements whereby the states would vacate the income tax field in

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[69]Both federations made increased use of special assistance to the poorer states during the depression. In Canada, the Duncan grants augmented financial aid to the maritime provinces and special grants were also awarded to the prairie provinces. The Australian federal government likewise made additional grants to the "claimant" states of Western Australia, South Australia and Tasmania and in 1933 set up the Commonwealth Grants Commission to systematize the distribution of these subsidies. A. Milton Moore, J. Harvey Perry and Donald I. Beach, "The Financing of Canadian Federation," p. 411 and Eric J. Hanson, "Federal-State Financial Relations in Australia," pp. 530-33; both in U. S., Congress, Joint Economic Committee, *Revenue Sharing*, Vol. I.

[70]Wheare, *Federal Government*, p. 110.

return for compensating grants from their respective federal governments.[71] The use of federal to state grants was less significant in the United States. Federal grants as a proportion of state income (not including the insurance trust funds) in that country stabilized after the mid-1930's and remained at about 16 per cent until the late 1950's.[72] By 1960 this figure had risen to over 22 per cent, with the increase largely due to expenditures on the federal highway program.[73] The Canadian provinces were receiving approximately the same percentage of their income from the federal government as were the American states, while in Australia the comparable figure in the 1959-60 financial year was 37.5 per cent.[74] The Swiss cantons received only about 10 per cent of their incomes from federal grants in 1960, but were, in addition, enjoying sizeable amounts of revenue from tax sharing schemes.[75]

The "new" federations.—The fiscal systems of the post-World War II federations (India, Pakistan, Malaya, Rhodesia and Nyasaland, Nigeria and the West Indies) were conditioned by a different set of factors than were those

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[71] *Ibid.*

[72] Mosher and Poland, *American Governments*, p. 55.

[73] *Ibid.*

[74] Wheare, *Federal Government*, p. 111.

[75] *Ibid.*

of the older federations. Perhaps benefiting from the experience of the older federations and/or responding to the implications of the "revolution of rising expectations," the framers of the constitutions in these newer nations generally foresaw a greater economic and social role for the public sector.

As a result of this attitude, greater care was taken in delineating the sources of revenue to be employed by the federal and state governments. In general, the constitutions of these modern nations separated the tax sources of the governmental units to a far greater degree than was noted in the United States, Canada, Australia and Switzerland. Whereas the constitutions of the latter group of nations left wide areas of taxation open to concurrent jurisdiction, the trend in the former group was to enumerate all national government taxes and leave the others to the states.[76]

Except for the short-lived West Indian federation, all of the postwar federations chose to have the national government in the dominant financial position. The greatest degree of centralization can be noted in Malaya. In this country, the national government was given jurisdiction over

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[76]M. M. Watson, "Federalism and Finance in the Modern Commonwealth," *Journal of Commonwealth Political Studies*, III, No. 2 (1965), 119.

almost all conceivable types of taxation including the personal income tax, corporation tax, import and export duties, excises, sales taxes, land taxes, stamp duties and vehicle taxes. The state governments were only empowered to obtain revenue from licenses, lands and mines dues and forestry dues.[77] The West Indian federal government, on the other hand, was given no exclusive tax sources and was allowed to exploit the personal income tax, corporation tax and import duties only in competition with the states.[78]

Following the example of the older federations, the constitutions of the new federations generally conferred the power to borrow on both the federal and state governments. Federal restrictions on state borrowing, however, were somewhat greater in the latter group of countries. External borrowing by the states was completely prohibited in India, Malaya and Nigeria and was subject to federal control in Pakistan. The power to borrow abroad was open to the states only in the West Indian federation; in Rhodesia and Nyasaland it was controlled by a Loan Council based on the Australian model.[79] This federal control over external borrowing may prove to be a primary centralizing force in these countries

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[77] *Ibid.*, pp. 125 and 127.

[78] *Ibid.*, p. 120.

[79] R. L. Watts, "Comment," in U. K. Hicks *et. al.*, *Federalism and Economic Growth*, pp. 143-44.

as most of them will probably have to rely on foreign credit for their development needs for many years.[80]

Due to the initially superior financial position of the federal governments in the new federations, the lower units of government have generally been left with few independent sources of revenue. Since both the federal and state governments are called upon to perform large numbers of functions, the problem of disequilibrium between functions and revenues arose early in the history of all six postwar federations. In anticipation of this problem, provisions for the transfer of resources from the center to the units were included in their constitutions.

The primary methods chosen to carry out the task of distributing funds were tax sharing and grants-in-aid. The first method has been especially important in India, Pakistan and Nigeria, although the state governments in each of these countries were to receive a portion of their revenues from grants-in-aid. Grants-in-aid, however, have only been important sources of state revenue in India, Pakistan and Malaya. They were totally absent in the federations of Nigeria, West Indies and Rhodesia and Nyasaland.

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[80]One author speculates that federal control of external borrowing in the new Commonwealth federations may have as great an impact on intergovernmental relations as did the growth of the social services in the older federations. Peter Robson, "Patterns of Federal Finance in the Newer Federations," *Finanzarchiv*, XII (April, 1962), 425-26.

Summary

Perhaps the most important aspect of fiscal federalism brought out in the preceding text is its changing character. Experience has shown the value of studying federalism as a process. The intergovernmental financial relationships which presently exist in the United States, Canada, Australia bear little resemblance to those which were originally in effect. The "ideal" federalism of Professor Wheare has given way to a cooperative federalism under the pressures of war, economic depression, rising aspirations and the welfare state. Expanded public activity in almost every area has necessitated this occurrence.

After many years of trial and error, it has been realized that the goal of precisely matching public responsibilities with independent resources at all levels of government is a utopian task. This realization has prompted the increased use of revenue transfers between the federal government and the states and between the states and the local units. Centralization of revenue collection by itself, however, need not destroy federalism. The ever present danger of state-local subservience to the federal government can be avoided if these units are able to maintain control over the performance of the several functions which they perform best. In order to accomplish this task, the state and local governments must be allowed to spend a

sizeable portion of the revenues they receive from higher levels of government in an independent manner.

As a result of the apparent need for extreme financial centralization in the developing countries, the applicability of a true federal system in these nations is open to question. The expression of any political autonomy at the state and local levels will become meaningless if adequate independent revenues are not available to them. The existence of a voluntary grant system from the national government to the lower units is, like in the older federations, the most likely avenue of eventual federal domination. In this respect, one author has remarked that "if the strong rise in the proportion of grants in total revenue manifested in India and Pakistan during the last few years were to continue, it would not be long before the units became *in this respect* subordinate to a degree hardly admissable in a federation, even allowing for a fairly flexible interpretation of the modern co-operative definition."[81] The alleviation of this particular problem may lie in the implementation of an impartial grants commission patterned on the Australian example. Financially weakening the federal government to the benefit of the states is probably not a

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[81]Watson, "Modern Commonwealth," p. 129.

feasible solution, as the demise of the West Indian federation seems to indicate.[82]

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[82]For background information on the failure of the West Indian federation see: E. Wallace, "The West Indies: Improbable Federation?," *Canadian Journal of Economics and Political Science*, XXVII, No. 4 (1961), 444-59.

CHAPTER II

THE BASIS FOR A BRAZILIAN FEDERALISM

In the preceding chapter it was stated that the adoption of a federal form of government depends upon certain prerequisites. The most fundamental of these being a desire for unity concurrent with a desire for the preservation of regional diversities. When a particular balance between these demands exists in a nation, federal government may be appropriate. If the desire for union overwhelms the desire for diversity, then a unitary form of government may be more suitable. A confederation, on the other hand, may be the administrative solution in a society which, above all, prizes regional diversity.

The present chapter seeks to assess the appropriateness of federal government in Brazil. More specifically, it attempts to isolate and analyze the federal qualities of Brazilian society. The constitutional and legal aspects of federalism in Brazil are temporarily ignored as they will be more thoroughly discussed in the following chapter. The omission of this facet of federalism, however, need not detract from the goal of the present discussion since "the essential nature of federalism is to be sought for, not in the shadings of legal and constitutional terminology, but

in the forces—economic, social, political, cultural—that have made the outward forms of federalism necessary."[1]

Unity and Diversity

One of the foremost characteristics of Brazil is its sheer immensity. The Brazilian nation, comprising an area of over three million square miles, is the giant of South America. Its territory covers almost one-half of that continent and is larger than the United States in terms of contiguous land area. The population of the country, now surpassing 90 million inhabitants, is the eighth largest in the world (after China, India, Russia, the United States, Indonesia, Pakistan and Japan). Furthermore, Brazil's annual rate of population growth, presently in excess of 3 per cent, is greater than that of the seven countries which have numerically superior populations. Estimates indicate 200 million Brazilians by the end of this century.[2]

As might be expected, there is much diversity within this huge country in terms of topography, climate, race, resource endowment, income levels and historical background. Moreover, these diversities are generally dispersed according to geographical regions. In addition to this diversity,

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[1]Livingston, "Nature of Federalism," pp. 83-84.

[2]Artur Hohl Neiva, "The Population of Brazil," in *Population Dilemma in Latin America*, ed. by J. Mayone Stycos and Jorge Arias (Washington, D. C.: Potomac Books, Inc., 1966), p. 56.

however, there is a strong sense of national unity. A common language, religion, law and general culture have nurtured a society which is in many ways more homogeneous than the successful Swiss federation or the newer Indian federation.

Ostensibly, then, Brazil would seem ideally suited to the federal system if we are to accept the belief that a successful federation requires the twin attributes of unity and diversity. An evaluation of this hypothesis in reference to Brazil, however, must be delayed to the final chapter, since only the hindsight made possible by historical analysis can prove or disprove this contention. For the present, it will suffice to sketch in somewhat greater detail those forces for union and disunion which have influenced the particular variant of federalism found in Brazil.

Pre-Federation Historical Background

The Colonial Period

The three hundred years of Portuguese colonial rule left an indelible imprint on Brazil. Besides implanting the unifying influence of Iberian culture, the patterns of settlement and methods of administration utilized during this era introduced the basis for regional diversity.

In 1533, three decades after the discovery of Brazil, the Portuguese Crown made its first serious attempt to colonize its new domain. To this end, large tracts of land (*donatárias*) were divided as hereditary captaincies. The twelve recipients of these grants (*donatários*) were to develop and defend their territories in addition to being the administrative agents of the Crown. Due to various factors, only two of these land grants (São Vincente and Pernambuco) ultimately flourished, but the original captaincy system had a lasting influence.[3] That is, "the fragmentation of Brazil into separate colonies in the 1530's gave birth to the concept of many Brazils that persists in the deeply ingrained sense of regionalism in the nation."[4]

The failure of the captaincy system less than two decades after its inception set the stage for an administrative centralization. After 1549, Portuguese control over Brazil was increased through several methods. Among these were the appointment of a captain-general, the limitation of the political powers of the original donatários and the establishment of a colonial capital in Bahia (changed to Rio de Janeiro in 1763).[5]

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[3]Six present-day states (Maranhão, Ceará, Rio Grande do Norte, Pernambuco, Bahia and Espírito Santo) retain the names of the captaincies from which they developed.

[4]Rollie E. Poppino, *Brazil: The Land and People* (New York: Oxford University Press, 1968), p. 53.

[5]Hubert Herring, *A History of Latin America* (2nd ed. rev.; New York: Alfred A. Knopf, 1967), p. 221.

Portugal's system of indirect rule through viceroys, captains-general, governors and majors-general[6] remained in effect throughout the colonial period, but was never really adapted to the needs of a vast, underpopulated country. Public officials were concentrated in the principal cities and towns, thus leaving large areas of settlement virtually devoid of any royal authority. Although a governor was theoretically empowered to exercise a wide array of controls over his respective captaincy, his actual authority was diminished through the interference of the home government, lesser officials and administrative organs and the general unruliness of the population.[7]

As a result of these shortcomings of colonial administration and the lack of adequate transportation and communication among the several captaincies, Brazil ultimately came to be ruled by the large plantation owners (*fazendeiros*) and not by the Portuguese Crown.[8] Despite

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[6]These titles were all essentially similar in that they designated the administrative head of a captaincy. The title of "captain-general" or "governor," however, was given to the head of a "principal captaincy" while the "subordinate captaincies" were governed by "captains-major" or simply "governors." After 1763, the captain-general of Rio de Janeiro was known as the "Viceroy of Brazil" although his *de facto* authority was no greater than that of the other governors. Caio Prado, Jr., *The Colonial Background of Modern Brazil*, trans. by S. Macedo (Berkeley: University of California Press, 1967), p. 357.

[7]*Ibid.*, pp. 359-61.

[8]Herring, *History of Latin America*, p. 227.

these factors which tended to fragment the Brazilian population, however, a semblance of national consciousness began to appear well before the end of the colonial period. An abortive uprising in 1788 signaled the beginning of organized opposition to Portuguese rule. One author speculates, though, that "federation, had it been applied at this time, would have spelled the break-up of Brazil. . . ."[9]

The Empire

Independence from Portugal was finally achieved in 1822, but a system of federal government was not to be adopted for sixty-seven years.[10] Instead, the country was ruled as an empire. The Constitution of 1824, which was in effect during this period, was centralist in nature, although it did provide for popularly elected provincial and municipal assemblies. These assemblies, however, were subject to the control of presidents appointed by the emperor. In addition, the central government retained virtually complete control over the nation's public finances. These new arrangements between the central government and the subordinate units prompted one author to state that:

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[9]Percy A. Martin, "Federalism in Brazil," *Hispanic American Historical Review*, XVIII, No. 2 (1938), 144.

[10]In 1808, John VI of Portugal fled to Brazil to escape the invading armies of Napoleon and set up a government-in-exile which lasted until 1821. A Brazilian historian has remarked that "the establishment of the Portuguese court in Rio de Janeiro favored a *rapprochment* of the captaincies and marked in a certain fashion the beginnings of the country's unity." José Honório Rodrigues, *The Brazilians: Their Character and Aspirations*, trans. by Ralph Edward Dimmick (Austin: University of Texas Press, 1967), p. 81.

> Under the constitution of 1824, . . . the provinces were in reality mere administrative subdivisions of the empire, without either political or economic autonomy of their own. The central government in the exercise of its power to determine all forms of taxation and to fix the amount of expenditures in the provinces as well as in the national government stifled the economic development of the former in the interests of the latter. . . .[11]

During the early years of the empire, many regional revolts took place and in 1834 the constitution was modified by granting a degree of autonomy to the provinces. Through this amendment (the *Ato Adicional*) the provincial assemblies were empowered to legislate in several areas pertaining to provincial and municipal affairs including public works, police protection, education, highways and navigation. Powers to finance these responsibilities were also included, although they were somewhat limited.[12] This constitutional modification, however, did not end the problems of regionalism and revolts continued in Bahia, Rio Grande do Sul, Maranhão, Minas Gerais, São Paulo and Pernambuco. The uprising in Pernambuco, which was successfully suppressed in 1849, is generally considered to have been the last real threat to the unity of the Empire.[13]

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[11]Herman G. James, *The Constitutional System of Brazil* (Washington, D. C.: Carnegie Institution, 1923), p. 5.

[12]According to the Ato Adicional, the provincial assemblies could legislate on the contraction of debts and "the raising and spending of public moneys for municipal and provincial expenditures, *provided they did not interfere with the general revenues of the central government.*" *Ibid.*, p. 7.

[13]Herring, *History of Latin America*, pp. 734-35.

Partially as a result of these regional disturbances, the national parliament passed subsequent laws which served to abrogate much of the autonomy given to the provinces through the Ato Adicional. One effect of the passage of these laws was the fiscal impoverishment of the provinces, since the central government gained control over virtually all lucrative revenue sources. Herman G. James notes that "this financial impotence of the provinces resulted in their becoming gradually as politically subordinate to the central government as before, for the support and financial assistance of the imperial government were conditioned upon the political subservience of the provincial authorities."[14]

Throughout the remainder of the Empire, Brazil was ruled by Pedro II as a strongly centralized monarchy. Sometimes accused of being a dictator, this emperor did manage to maintain the large land area of Brazil intact. Improvements in the nation's transportation and communication networks in the latter half of the 1800's greatly aided this accomplishment.[15] By 1889, however, conflicts between the central government and the Church, dissatisfaction within the army,

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[14]James, *Constitutional System of Brazil*, pp. 7-8.

[15]Under the impetus of the Paraguayan War (1864-70), the telegraph and railroad networks were greatly expanded. During the war years, Rio de Janeiro was connected to Buenos Aires by telegraph and the amount of railroad track in the country was increased by 80 per cent (to a total of 450 miles). Poppino, *Brazil: The Land and People*, pp. 205-06.

increasing republican sentiment and the issue of slavery brought an end to the imperial era and Brazil finally emerged as a federal republic.[16]

The Historical Impact in Summary

From the outset of federation, the public administration of Brazil had a definite bias towards centralization. A large part of this tendency can be attributed to the influence of the centralized monarchy under which the country had been ruled for the previous seven decades.[17] As a result, Brazil became a federation by "disaggregation," that is, a previously unitary government had split into component parts.[18] When a federation is formed in this manner, the burden of asserting political and financial autonomy is placed upon the state and local governments. If these units have had little or no experience with self-government (as was the case in Brazil), the task is made far more difficult. To further complicate matters, the first federal constitution of Brazil (to be discussed

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[16]Herring, *History of Latin America*, pp. 743-46.

[17]In this respect, José Honório Rodrigues states that "it is to the triumph of central power in Rio de Janeiro [during the Empire] over local and provincial authority that the unity of the nation must be attributed." Rodrigues, *Character and Aspirations*, p. 81.

[18]This is in contrast to the inception of federalism in the United States, Canada, Australia and Switzerland in which previously independent units had formed a union, that is, a "federation by aggregation."

more fully in the following chapter) was patterned on the American Constitution and represented an ideology which was essentially alien to a culture predominately based upon Iberian influences.[19]

Even though the imperial administration successfully molded Brazil into a national unit, a significant degree of regional diversity was still able to maintain itself. Perhaps the most important factor in this respect was the absence of *effective* national authority during the colonial period in areas isolated by lack of transportation and communication facilities. By the time some semblance of national administration could be realized, this regionalism had been irrevocably implanted. This fact is attested to by the series of regional revolts which extended into the twentieth century and the popular allegiance to state governments that often superceded allegiance to the federal government.

Contemporary Forces

With this brief discussion of the country's historical background in mind, we now turn to those federal

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[19] In referring to the American Constitution's emphasis on "states' rights" which was incorporated in Brazil's first federal constitution, one emminent scholar has noted that "the problem of combining diversity with unity . . . seems to have suffered as much from the political methods . . . adopted by the Federal Republic of 1889 as from the centralization methods followed by the Empire." Gilberto Freyre, *New World in the Tropics: The Culture of Modern Brazil* (New York: Alfred A. Knopf, 1959), p. 105.

qualities which exist in present-day Brazil. While some of these contemporary forces will be recognized as being simple extensions of the society formed in the colonial and imperial eras, others reveal tendencies which are quite modern.

The Forces for Union

Cultural

Perhaps the most important unifying force in Brazil is what Charles Wagley refers to as its "remarkably homogeneous national culture."[20] Although basically Portuguese-oriented, this culture has also been influenced to some degree by the heritage of the African slaves and indigenous Amerinds. This amalgamation of influences has produced a culture which exhibits similarities to that of Portugal, but is at the same time distinct.

Language.—One obvious legacy of the Portuguese was their language. Extremely valuable as a unifying force, Gilberto Freyre calls it the most important means "of inter-regional and interhuman communication" in Brazil.[21] At present, Portuguese is spoken throughout the country, except for in some isolated Indian tribes and among a few unassimilated Europeans. The language as it exists today

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[20]Charles Wagley, *An Introduction to Brazil* (New York: Columbia University Press, 1963), p. 1

[21]Freyre, *New World in the Tropics*, p. 101.

is generally distinct from the Iberian version in terms of pronunciation, syntax and word usage and is flavored with both American Indian and African influences. Regional accents and dialects within Brazil, however, are "less noticeable than those between a New England Yankee and a person from the Deep South."[22]

Religion.—Another unifying force which also emanates from the Portuguese heritage is religion. During the colonial and imperial periods, Roman Catholicism was the official State religion although freedom of worship was generally allowed. With the inception of the federation the Church and State were officially separated. The Catholics continued to dominate the religious orders, though, and in 1950, about 94 per cent of all Brazilians were members of this Church.[23]

The number of Brazilian Catholics, however, belies the extent of the power and influence of the organized Church. Although Catholicism pervades almost every segment of Brazilian society, it is often regarded more as a tradition than as a strong faith.[24] Moreover, "most of the differentiation along religious lines has occurred within or been

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[22]Wagley, *Introduction to Brazil*, p. 4.

[23]Smith, *Brazil: People and Institutions*, p. 511.

[24]Wagley, *Introduction to Brazil*, pp. 232-51.

incorporated into the general framework of this universal body."[25] Such differentiation, often the result of combining either African or Indian religions with the Roman Catholic tenets, has seemingly detracted from this Church's potentially monolithic structure. Nevertheless, Roman Catholicism is still very much an integral part of Brazilian society and as such must be considered as one of its unifying forces.

Developmental

In addition to these cultural factors, largely based on historical precedent, forces of more recent origin have also fostered Brazilian unity. Among the most significant of these are those which have arisen from the post-World War II drive for accelerated economic development. The increased administrative centralization and sense of national commitment accompanying this goal have no doubt had some positive effect on national unity, but the most important factor in this respect has probably been the recent expansion of the country's transportation and communication (especially the former) networks. By expediting personal and commercial intercourse between the regions of Brazil, these networks have done much to alleviate the centuries-old problem of rural isolation. The major cities

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[25]Smith, *Brazil: People and Institutions*, p. 510.

of Brazil are also more closely connected as a result of this phenomenon.

Transportation.—Improvements in overland transportation in recent decades have been dominated by highway construction and paving as the railroad system has deteriorated.[26] Although modern highway construction generally began during the late 1920's, it did so at a fairly slow pace and by 1947, only 276,000 kilometers had been built.[27] After World War II, however, increased interest in this area prompted a reorganization of national and state highway departments and the creation of a "national roads fund" which was to be financed through the earmarking of revenues from a newly imposed tax on petroleum.[28]

The initial postwar enthusiasm for highway construction was maintained during the 1950's and into the early 1960's; by 1965, the national highway network had surpassed the 800,000 kilometer mark.[29] Furthermore, the

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[26]Total extension of track increased from 31,333 kilometers in 1926 to only 38,287 kilometers by 1960. Brazil, IBGE (Instituto Brasileiro de Geografia e Estatística), *Anuário Estatístico—1962* (Rio de Janeiro, 1962), p. 107.

[27]U. S. Department of Commerce, *Brazil: Information for United States Businessmen* (Washington, D. C.: Government Printing Office, 1961), p. 138.

[28]*Ibid.*

[29]Brazil, IBGE, *Anuário Estatístico—1966*, p. 239. Of no small consequence in this phenomenal growth was the moving of the national capital from Rio de Janeiro to Brasília in 1960. The transfer of the capital city to this previously remote area necessitated the building of a system of connecting roads which now extend to all regions of the country.

number of motor vehicles in Brazil generally paralleled this growth of highways. While in 1946 there were only 219,000 such vehicles registered in the country, there were almost 2 million in 1965.[30] A summation of the effects of this phenomenon is offered by Rollie Poppino: "the expansion of the network of motor roads brought large areas of rural Brazil under the political, economic, and cultural influence of the state and national capitals, and made it more difficult for the people of interior communities to resist the forces of change that had been at work in the coastal cities since the last quarter of the nineteenth century."[31]

The two other major means of transportation, air and maritime, have also made gains in recent decades. Aviation, which was initially encouraged by the relative lack of other efficient means of transportation, made its first appearance in Brazil in the late 1920's. Since that time it has rapidly increased in importance both as a carrier of passengers and of freight, especially in the postwar years. In the period 1946-63, for example, the number of air passengers grew from 511,818 to 3.5 million; with passenger-kilometers increasing from 395 million to over 3.5 billion.[32]

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[30]Brazil, IBGE, *Anuário Estatístico—1947*, p. 192 and Brazil, IBGE, *Anuário Estatístico—1967*, p. 303.

[31]Poppino, *Brazil: The Land and People*, pp. 298-99.

[32]Brazil, IBGE, *Anuário Estatístico—1947*, p. 211 and Brazil, IBGE, *Anuário Estatístico—1966*, p. 252.

Air cargo experienced similar growth, increasing from about 7,000 tons in 1946 to over 70,000 tons in 1963.[33]

Maritime shipping has traditionally been of great significance in connecting the population clusters along the Brazilian coast. With the rapid growth of highway travel, however, the relative importance of this means of transportation has somewhat lessened in terms of the volume of merchandise carried, but in 1958 still accounted for 34 per cent of the total.[34] Although the number of ships entering Brazilian ports actually declined between 1946 and 1965 (from 32,941 to 22,054), the registered tonnage of these ships more than doubled (from 25 million tons to 60 million tons).[35]

Communications.—The principle means of communication in Brazil are radio, telegraph, telephone, television and the newspapers and periodicals. A potentially significant unifying force, communications between the various regions of Brazil and between the cities and the hinterland are as of yet quite underdeveloped. Facilities tend to be concentrated in the eastern and southern areas of the country and the expense involved in the purchase of a television or

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[33] *Ibid.*

[34] U. S. Department of Commerce, *Information*, p. 135.

[35] Brazil, IBGE, *Anuário Estatístico—1947*, p. 199 and Brazil, IBGE, *Anuário Estatístico—1966*, p. 251.

telephone tend to confine their ownership to a relatively small segment of the population.[36] The circulation of newspapers and periodicals and the telegraph system are more widespread, but also involve a purchase price which puts them out of the reach of much of the general populace. Furthermore, their use as a unifying device is hindered by the fact that about 50 per cent of the Brazilian population is illiterate.

The Forces for Diversity

As was mentioned previously, Brazil has been characterized by an "ingrained sense of regionalism" since colonial days. Differences in topography, race, nationality, economic activity and income levels and historical backgrounds have produced highly diverse areas within the country. Since this regionalism probably represents the most important factor in favor of a federal system in Brazil, it is to be discussed in some detail.

The Regions

One authority on Latin America has remarked that "no real understanding of Brazilian problems can be gained without an examination of the parts of the country."[37] This

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[36]Radios, however, are found in virtually every part of Brazil and serve as an important link between the urban and rural areas. For some comments on the radio as an instrument of cultural diffusion see: Manuel Diégues, Jr., *Regiões Culturais do Brasil* (Rio de Janeiro: INEP—Ministério de Educação e Cultura, 1960), p. 494.

[37]Preston E. James, *Latin America* (3rd ed.; New York: Odyssey Press, 1959), p. 385.

statement seems especially applicable to a study of the problems of Brazilian federalism. For the present discussion, Brazil will be considered in terms of five major regions: the North, Northeast, East, South and Central West. Although this division is not entirely acceptable for all purposes, it is the one adopted by the Brazilian Council of Statistics and is widely used within the country.[38]

The North.—As Figure 1 illustrates, the Brazilian North is comprised of the states of Pará, Amazonas and Acre as well as the territories of Amapá, Roraima and Rondônia. Encompassing most of the Amazon River basin, this region covers 42 per cent of the total national land area but contains only 3.6 per cent of the Brazilian population (see Table 1). Although the number of persons living in this region increased by 41 per cent between 1950 and 1960, it still ranks as the least populous of the five regions.[39]

The topography of the North is dominated by humid lowlands containing the world's largest tropical rain forest,

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[38]The main source of difficulty in this division seems to be the inclusion of the states of Sergipe and Bahia in the eastern region since both exhibit some characteristics which qualify them as northeastern. For the purpose of some analyses later in the text, both states will be included in the Northeast. The arrows in Figure 1 call attention to this point.

[39]Brazil, IBGE, *Anuário Estatístico—1962*, p. 27.

Figure 1. Brazil's Major Regions.

TABLE 1

Selected Regional Characteristics, 1960

Region	Land Area (% of total)	Population (% of total)	Per Capita Income (% of national average)	Industrial Production (% of total in sector)	Strong Non-Iberian Cultural Influences
North	42	4	61	2	Amerindian
Northeast	11	22	50	5	African (in coastal zone)
East	15	35	98	32	African (coastal Bahia)
South	10	35	146	60	European
Central West	21	4	60	1	Mixed

Source: Land area, population and per capita income data computed from Brazil, IBGE, *Anuário Estatístico—1962*, pp. 12, 25 and 197; industrial production data adapted from Baer, *Industrialization*, p. 171; information on culture taken from Smith, *Brazil: People and Institutions*, *passim* and Wagley, *Introduction to Brazil*, *passim*.

although small plain and highland areas can be noted.[40] The Amazon River and its tributaries provide a convenient means of transportation throughout the area and as a consequence most of the population is concentrated along these water routes.

The culture of the area is highly influenced by the American Indian, although only about 10,000 to 20,000 of them still remain.[41] Agricultural techniques, folk beliefs and folklore all reflect the Indian heritage. Few Negro slaves were brought to the region and the present racial composition is predominately a Portuguese-Indian mixture.[42]

In the nineteenth and early twentieth centuries, this area held a virtual monopoly of world rubber production. The initial boom, however, was over by 1912 as plantings in British Malaya and Dutch Sumatra flooded the market. Economic activity today is based on extractive agriculture (rubber, Brazil nuts, pepper, manioc), minerals (principally manganese) and light manufacturing (textiles, food processing, lumber, leather). The structure of the regional economy is such that industry generates 26 per cent of the area's income while agriculture accounts for about 25 per cent. Commerce,

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[40]James, *Latin America*, pp. 540-41.

[41]Wagley, *Introduction to Brazil*, p. 64.

[42]Charles Wagley, "Regionalism and Cultural Unity in Brazil," *Social Forces*, XXVI, No. 4 (1948), 458.

services and government contribute 17, 11 and 10 per cent, respectively, to the regional income.[43] In 1960, the North accounted for 2.2 per cent of Brazil's national income; its per capita income being 61 per cent of the national average.[44]

The Northeast.—The northeastern region of Brazil contains the states of Maranhão, Piauí, Ceará, Rio Grande do Norte, Paraíba, Pernambuco and Alagôas. Its land area of about 580,000 square miles represents 11.4 per cent of the national territory and its population, in excess of 15 million, is about 22 per cent of the Brazilian total (see Table 1). Due principally to out-migration, the Northeast experienced the slowest rate of population growth (about 25 per cent) among the five regions between 1950 and 1960.[45]

This region is in many ways the most heterogeneous of Brazil. The basis for much of this diversity is the widely differing landscapes and climates to be found within the area. According to Preston E. James, the Northeast can be topographically divided into two distinct parts; the "Zone of the Mata" and the "Zone of the Caatingas."[46]

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[43]Baer, *Industrialization*, p. 171.

[44]Stefan H. Robock, *Brazil's Developing Northeast: A Study of Regional Planning and Foreign Aid* (Washington, D. C.: Brookings Institution, 1963), pp. 35-35 and Table 1 above.

[45]Brazil, IBGE, *Anuário Estatístico—1962*, p. 27.

[46]James, *Latin America*, p. 410.

The former zone, characterized by generally fertile soils and dependable rainfall, stretches along the coast in a narrow band south of the state of Rio Grande do Norte (see Figure 1). The latter zone, comprising much of the interior of the Northeast, is the chronically depressed area of Brazil. Plagued by alternating droughts and floods, the "Zone of the Caatingas" is covered with a hard, sandy soil in which grows a varied assortment of drought-resistant bushes and trees.

The cultural and economic patterns of the region are highly influenced by their respective geographical zones.[47] Due to a sugar boom in the seventeenth and eighteenth centuries which necessitated a large importation of Negro slaves, the African influence is strong in the coastal area. Many typical foods and religious cults of the "Zone of the Mata" have African origins.[48] The arid interior zone, in contrast, exhibits little of the Negroid element, since the economic activity of the area was never sufficiently profitable to encourage the introduction of slavery. The racial composition today is largely Portuguese-Indian, with the culture being "basically Iberian but

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[47]The Northeast is also beginning to be affected by the introduction of cultural patterns transplanted from the southern regions of Brazil by returned migrants. Diégues, *Regiões Culturais do Brasil*, pp. 496-97.

[48]The coastal zones of Sergipe and Bahia, in Brazil's East, share these influences.

strongly marked by the necessity of adapting human life to a hostile and inhospitable environment."[49]

Once the most prosperous region of Brazil (during the sugar boom), the Northeast is now the poorest. The region accounted for 11 per cent of the national income in 1960, but per capita income was only one-half of the Brazilian average.[50] Agriculture dominates the structure of the northeastern economy, accounting for 47 per cent of the regional income. Commerce, services and industry rank next in importance, generating 15, 12 and 4 per cent, respectively, of the income.[51]

Within the agricultural sector, the major sources of income are cultivated field crops like cotton, sugar and manioc. In the poorer parts of the region, though, the grazing of cattle or goats is the most common economic activity. The industrial sector of the Northeast is relatively underdeveloped and, as mentioned above, accounts for only a small portion of both the region's income and the national output (see Table 1). As of 1958, food, textiles, chemicals and nonmetallic minerals comprised about 75 per cent of total factory employment and value added

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[49]Wagley, "Regionalism," p. 459.

[50]Baer, *Industrialization*, p. 169 and Table 1 above.

[51]Baer, *Industrialization*, p. 170.

in manufacturing (including Bahia and Sergipe).[52] Since the mid-1950's, industrialization efforts have accelerated due to increased electricity generating capacity, the availability of long-term credit and special incentives of the federal government (to be discussed in a subsequent chapter).

The East.—The eastern region of Brazil contains the states of Sergipe, Bahia, Minas Gerais, Espírito Santo, Rio de Janeiro and Guanabara. With a land area covering 15 per cent of the national territory, the East holds about 34 per cent of the Brazilian population (see Table 1). This population, however, is quite unevenly distributed among the component states. The 2,995 persons per square kilometer in the state of Guanabara (the city of Rio de Janeiro) can be contrasted with the 12 persons per square kilometer found in the state of Bahia (1967).[53]

The topography of the East is quite complex, but does not exhibit the extreme contrasts found in the Northeast. Generally characterized by hilly areas and small mountains, transportation within the area is difficult. An escarpment running parallel to the coast impedes overland travel to the interior and rivers in the area are generally poor for

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[52]Robock, *Brazil's Developing Northeast*, p. 51.

[53]Brazil, IBGE, *Atualidade Estatística do Brasil—1968* (Rio de Janeiro, 1968), p. 28.

transportation purposes.[54] Climate and vegetation are largely dictated by altitude, with the low coastal areas being characterized by tropical conditions and the upland areas being more temperate. The interiors of Bahia and Sergipe are within the "Zone of the Caatingas" and resemble those of the northeastern states.

The Brazilian East is a culturally diverse region. While the northern part (Bahia, Sergipe) shares strong cultural affinities with the Northeast, the southern part (especially Minas Gerais, Rio de Janeiro and Guanabara) are "more in tune with twentieth-century trends in Western society."[55] Traditional values, however, can still be noted in the rural areas of these latter states.[56]

Economic activity in the region is as diverse as its culture, ranging from subsistence farming and grazing in the arid backlands to modern industrial production in Minas Gerais, Rio de Janeiro and Guanabara. The East accounts for 34 per cent of the national income and its

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[54]James, *Latin America*, pp. 412-13 and 434-37. An exception is the São Francisco River which rises in the state of Minas Gerais and flows northward for thousands of miles through the backlands of Bahia and Pernambuco.

[55]Poppino, *Brazil: The Land and People*, p. 28.

[56]Charles Wagley contends, in fact, that the "Eastern Highlands . . . is the region par excellence in which to seek the traditional patterns of Brazilian national culture." Wagley, *Introduction to Brazil*, p. 58.

per capita income approximates the average for Brazil.[57] This latter figure is somewhat misleading, however, since it conceals substantial intraregional variations. The range spans from a per capita income of about half the national average in the state of Sergipe to one almost three times the national average in the state of Guanabara.[58]

The agricultural sector, which generates 26 per cent of the regional income, produces 20 per cent of Brazil's sugar, 40 per cent of its tobacco, bananas and coconuts; and 99 per cent of its cacao.[59] Large quantities of staple foods, like corn, beans, manioc and rice, are also grown in addition to a sizeable portion of the nation's livestock.

The industrial sector is generally well developed in Brazil's East and produces almost a third of the national output (see Table 1). Most of the county's iron and steel production takes place in the states of Rio de Janeiro and Minas Gerais, and food processing, consumer industries, petroleum refining and cement production are also important. Minas Gerais is noted for its mineral wealth (from whence it acquired its name "general mines"), and in the eighteenth century was the center of a gold rush. Although gold production is of little relative importance in this state

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[57]Baer, *Industrialization*, p. 169 and Table 1 above.

[58]Baer, *Industrialization*, p. 170.

[59]*Ibid.*, p. 171 and Poppino, *Brazil: The Land and People*, p. 30.

today, high-grade iron ore, nickel and manganese are presently mined in substantial quantities.

The South.—Brazil's South, made up of the states of São Paulo, Paraná, Santa Catarina and Rio Grande do Sul, is a region of superlatives. Although comprising only 10 per cent of the Brazilian territory, it is the most populous region, having slightly more inhabitants than the East. In addition, it is the wealthiest, most industrialized, most modern and is often called the most "dynamic." Development within the region is uneven, though, and São Paulo leads the other three states in almost every field of endeavor.

The region's landscape is possibly more complex than that of the East. The Great Escarpment, rising to elevations of more than 3,000 feet, continues along the coast and stretches southward to the city of Pôrto Alegre in the state of Rio Grande do Sul. In the interior one finds lowlands and valleys, hilly uplands and plateaus.[60] Although predominately in the temperate zone (the Tropic of Capricorn passes just north of the city of São Paulo), frost is only rarely experienced outside of the highlands. Vegetation in the highlands changes from tropical semi-deciduous forest to grass prairie as one moves southward

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[60]James, *Latin America*, pp. 504-08.

and pine forests appear in the state of Paraná; along the coast, tropical rain forest gives way to a lighter semi-deciduous forest in the northern portion of Rio Grande do Sul.[61]

The culture of the South is highly influenced by the large-scale European immigration into the area. Between 1888 and the beginning of World War I, about 2.5 million of these people entered the country. Although chiefly Italian and Portuguese, immigrants in sizeable numbers also came from Spain, Japan, Germany and Russia.[62] The state of São Paulo, which encouraged this immigration through public subsidies, was the recipient of the bulk of this flow.[63] Today, the influence of European culture in Brazil's South can be noted in many ways, including the mixed-farming system, crops, architecture and language. In the extreme southern part of Brazil, the impact of Hispanic culture is also strong, sharing many of the culture patterns of neighboring Uruguay and Argentina.

As has already been mentioned, the South is the country's wealthiest and most industrialized region.[64]

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[61] *Ibid.*, pp. 508-09.

[62] Smith, *Brazil: People and Institutions*, p. 126.

[63] In the peak year for immigration (1895), São Paulo received almost 140,000 persons or 83.5 per cent of the national total. *Ibid.*, p. 122.

[64] Industry is mainly located in the state of São Paulo which, by itself, accounts for 50 per cent of Brazil's industrial production. Robock, *Brazil's Developing Northeast*, p. 140.

With a per capita income almost 50 per cent greater than the national average, it produces 60 per cent of Brazil's industrial output (see Table 1). The region's industrial base is highly diversified but food processing, textiles, chemicals and pharmaceuticals are the most significant. In spite of the South's preemminence in industry, agriculture is the largest recipient of the regional income (33 per cent of the total versus 27 per cent for industry).[65] Coffee growing, concentrated in the states of Paraná and São Paulo, has been the basis for much of the political power which this region (the state of São Paulo in particular) has held since the late 1800's. It still dominates the agricultural sector (generating about 20 per cent of total agricultural income), although the South is now an important producer of beans, wheat, potatoes, manioc, cotton and other commodities.

The Central West.—The fifth major region of Brazil is the second largest in land area and the fastest growing in population. Comprised of two states, Mato Grosso and Goiás, and the Federal District (Brasília), the Central West accounts for about 22 per cent of the national territory but only 4 per cent of the population (see Table 1). The approximately 3 million persons residing in the area in

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[65]Baer, *Industrialization*, p. 171.

1960, moreover, represented a 70 per cent gain over 1950.[66]

The topographical setting of the Central West is one of the least diverse of Brazil's regions. Almost the entire region is a plateau varying in altitude from 1,000 to 3,500 feet. Vegetation ranges from tropical forest in the north and in some of the river valleys to subtropical forest, scrub brush and grasslands in other areas. An exception to the general configuration is the low wetlands of the Paraguay Valley in western Mato Grosso. This part of the region, called the *pantanal*, is a tropical savanna which is often flooded in periods of high water.[67]

Migrants from all areas of Brazil have entered the states of Goiás and Mato Grosso in search of agricultural land and valuable minerals and, as a result, the cultural patterns of the region are generally a reflection of "frontier" values. Boom towns are continually being erected and law and order is often entirely absent. Largely because of this heavy in-migration, the racial composition of the two states comprising the Central West approximates the national average in all categories except for "mixed" (*pardo*), in which it is significantly higher.[68] One author,

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[66]Brazil, IBGE, *Anuário Estatístico—1962*, p. 27.

[67]James, *Latin America*, pp. 530-32.

[68]Smith, *Brazil: People and Institutions*, p. 70.

in fact, predicts that the Central West may become the "most typically Brazilian region of the nation" if the flow of migrants from the older areas of the country continues unabated.[69]

The Central West accounts for only 2 per cent of the national income, while its per capita income is about 61 per cent of the national average.[70] Due to the rapid rate of population growth, however, per capita income has undergone a relative decline since 1953 (when it was 77 per cent of the national average).[71] Economic activity in the region is overwhelmingly agricultural, with this sector receiving 60 per cent of the regional income.[72] Within the sector, livestock is important as is the cultivation of rice, beans, corn, manioc, coffee and sugar. The region's industry is the most underdeveloped in Brazil and is relatively unimportant as a source of regional income. The moving of the capital of the country to the Central West, however, may prove to be a stimulating factor as improvements in basic infrastructure and a growing market make industrialization increasingly profitable.

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[69]Poppino, *Brazil: The Land and People*, p. 37.

[70]Baer, *Industrialization*, p. 169 and Table 1 above.

[71]Robock, *Brazil's Developing Northeast*, p. 36.

[72]Baer, *Industrialization*, p. 171.

Summary

The forces which shape modern Brazilian federalism have been at work in the country since the first Portuguese occupation in the sixteenth century. During the colonial period, which lasted until 1822, the impossibility of effective administration was conducive to the formation of regional diversities. This regionalism, still very much alive today, was later nurtured by such factors as the geographical concentration of foreign immigration and uneven economic development.

Despite this strong regionalism, however, Brazil has emerged as a unified nation, both politically and culturally. Real political and administrative unity came to the country only after three hundred years of colonial rule, that is, long after the roots of regionalism had been implanted. Nevertheless, the unifying influence of the Empire was effective and prevented the Balkanization experienced by some of Brazil's Spanish-speaking neighbors. Aiding the political unification of the country was the emergence of a distinct and pervasive Brazilian culture.

Today this culture is embodied in both formal and informal institutions. Of the former type one can note the common language, religion and family concept. Although basically Portuguese, they have been tempered by the

conditions of the New World to form a uniquely Brazilian pattern. Informal institutions, ranging from national heroes and national holidays to the national passion for soccer, have also arisen as important unifying forces. Some authors even speak of a common character and common aspirations. Brazil is thus a nation of unity but not of uniformity.

CHAPTER III

CONSTITUTIONAL AND LEGAL ASPECTS OF BRAZILIAN FISCAL FEDERALISM

Between 1889 and 1964, Brazil was governed under four constitutions. The purpose of this chapter is to present these documents in terms of their provisions pertaining to the public finances. The method of presentation is uniform for all four constitutions and concentrates on the two fundamental aspects of federal finance, that is, the administrative distribution of functional authority and revenue sources. Other provisions of the constitutions as well as supplemental laws will be discussed when relevant.

The concern of the present chapter is primarily of description and analysis. Little attempt, however, will be made to discuss the realities of Brazilian fiscal federalism. This task is undertaken in subsequent chapters.

The Constitution of 1891

Brazil's first federal constitution was promulgated in 1891, two years after the declaration of the republic.[1]

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[1]The text of the Constitution of 1891 may be found in Fernando H. Mendes de Almeida, ed., *Constituições do Brasil* (São Paulo: Edição Saraiva, 1961), pp. 103-207. For an English language translation see James, *Constitutional System of Brazil*, pp. 221-59.

Remaining in effect until 1930, this document served the nation throughout the period of Brazilian history known as the "First Republic" or the "Old Republic." The writers of the 1891 Constitution were highly influenced by the Constitution of the United States and adopted many of its features virtually intact. The former imperial provinces were converted to states and were delegated certain powers to govern their own affairs.

The Distribution of Functional Authority

The basic administrative division of responsibilities embodied in the 1891 Constitution included enumerated and prohibited powers at both the federal and state levels as well as powers which could be exercised concurrently. Like the American Constitution, Brazil's Constitution of 1891 reserved residuary powers to the states. To this effect, Article 65, Section 2 of the latter document provided that "the states enjoy in general every and any power or right not denied them by express provision of the constitution or by implication from such express provisions."

The Federal Government

The responsibilities delegated to the Brazilian federal government in the nation's first federal constitution were quite sweeping. Although scattered throughout the document, its exclusive powers are mainly found in

Article 34, under the heading "Powers of the Congress." Here one finds a list containing thirty-five sections outlining most of the functions customarily delegated to the national government in federal systems. Although too numerous to be discussed in detail here, they generally delineated federal hegemony over foreign affairs, national defense, currency and coinage, weights and measures, organization of the federal courts, execution of the federal budget and the regulation of both international and interstate commerce.[2]

Article 35 contained an exposition of the powers which were to be exercised concurrently by the national government and the states. Included among these were powers to "stimulate in the country the development of letters, arts, and sciences, as well as immigration and commerce . . ." (Section 2), "create institutions of higher and secondary instruction in the states" (Section 3) and "provide secondary instruction in the federal district" (Section 4).

The States

Since residuary powers were reserved to the states in the 1891 Constitution, few responsibilities were explicitly delegated to them. In addition to the concurrent

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[2]Additional powers, including the right to legislate on matters concerning labor, were embodied in the Constitutional Amendment of 1926.

authority included under Article 35, the states were, however, guaranteed self government through Article 63. This latter provision stated that "each state shall be governed by the constitution and laws which it may adopt, in conformity with the constitutional principles of the Union." In addition, the states were also responsible for the organization of the municipalities "in a manner that assures the autonomy of the municipalities in everything respecting their peculiar interests" (Article 67). Other enumerated state powers were of lesser importance and included the power to establish telegraph lines in areas not served by the federal government (Article 9, Section 4) and the power to legislate on railways and internal navigation as regulated by federal law (Article 13).

The Distribution of Revenue Sources

The constitutional division of revenue sources between the federal government and the state governments was primarily contained in Articles 7 and 9. Listed in Table 2, these various taxes and fees were to be levied exclusively by the administrative unit to which they were granted.[3] The federal government, however, was obliged to

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[3]An exception to this rule is to be found in Section 3 of Article 9 which provides that "a state may impose import duties on foreign goods only when destined for consumption within its own territory, the proceeds of the duties reverting, however, to the federal treasury."

levy its imposts uniformly among the states (Article 7, Section 2) and was prohibited from giving favors or preferences to the ports of one state as opposed to those of another (Article 8). The municipalities were not delegated separate revenue sources and were dependent on those given to them in the constitutions of their respective states.[4]

In addition to the separate revenue sources delegated in the Constitution, both the states and the federal government were free to levy other taxes, since there was no provision prohibiting overlapping jurisdiction (Article 12).[5] Furthermore, the sale of public debt by the federal government and the states, both in domestic and foreign markets, was not prohibited by the Constitution.[6]

The Amending Process

As pointed out in Chapter I, the nature of the amending process in a federal nation is crucial since it represents one of the most important means of constitutional change. In the Brazilian Constitution of 1891, the amending procedure was contained in Article 90.

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[4]The resulting diversity of municipal revenue sources throughout Brazil is discussed in detail in Chapter IV.

[5]In this category, both income and excise taxes attained some importance during the First Republic.

[6]Problems which arose from abuses of this power are discussed in Chapter IV.

In sharp contrast to its North American model, the Brazilian document was theoretically able to be amended by the federal government without the consent of the states. Amendments could be proposed by either the National Congress or the states, but the latter's proposal could be wholly rejected by the former. While the amending process remained as a potential avenue of federal domination throughout the period of the First Republic, it was apparently not abused.[7] The Constitution was amended only once during its forty-year duration (in 1926) resulting in relatively minor changes in the division of power between the federal government and the states.

Decree 19,398 of November 11, 1930

In 1930, the tenure of the 1891 Constitution came to an end as the national government was overthrown by forces led by Governor Getúlio Vargas of the state of Rio Grande do Sul. With the old Constitution suspended, Vargas' "Provisional Government" ruled Brazil for four years through Decree 19,398.[8] This decree became the *de facto* constitution

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[7]The provisions pertaining to the suspension of constitutional guarantees by the federal government (Article 90), however, were frequently employed to intervene in the affairs of the states. For more detail on this matter see Brazil, Documentos Parlamentares, *Intervenção nos Estados*, 16 vols. (Paris and Rio de Janeiro, 1893-1922?).

[8]The text of this Decree may be found in Almeida, *Constituições do Brasil*, pp. 221-26.

TABLE 2

Division of Exclusive Revenue Sources in the Constitution of 1891[a]

Federal	State
Tax on Imports	Tax on Exports
Stamp Taxes	Tax on Rural and Urban Real Property
Fees Levied on Ships	Tax on the Transfer of Property
Fees from Federal Postal and Telegraphic Services	Tax on Industries and Professions
	Stamp Taxes[b]
	Fees from State Postal and Telegraphic Services

[a]The municipal governments were not included in the distribution of separate revenue sources.

[b]"On documents issued by their respective governments and on affairs of their own economy" (Article 9, Section 1, Paragraph 1).

of the nation and formed the legal basis of Vargas' first period of dictatorship.

The main features of Decree 19,398 may be briefly outlined. In Article 1, the Provisional Government assumed discretionary powers through the combining of executive and legislative functions "until a Constituent Assembly established a constitutional reorganization of the country." In addition, the head of the Provisional Government was delegated the exclusive power to appoint or dismiss public officials.

Through Article 3 of the Decree, all legislative or deliberative bodies were dissolved, including the National Congress and the state and municipal assemplies. The federal and state constitutions, however, were to remain in effect "subject to the modifications and restrictions established by this law [Decree 19,398] or decrees or further acts of the Provisional Government or its delegates" (Article 4). The Decree, furthermore, held that the financial autonomy of the states and the federal district would be maintained (Article 9) and that the obligations assumed by the federal government, the states and the municipalities in terms of loans and other credit operations would remain in effect (Article 10).

In Article 11, it was stated that the head of the national government may appoint a federal delegate (called

an *Interventor*) in each state who would exercise both executive and legislative authority. The Interventor, in turn, was empowered to appoint the mayors (*prefeitos*) of the municipalities. Finally, any new constitution promulgated in the future was to maintain the federal and republican form of government and was not to restrict the rights of the municipalities and the citizens as guaranteed through the 1891 Constitution (Article 12).

The Constitution of 1934

After a period of internal disturbances and general discontent over the absence of constitutional government, a constituent assembly was formed through state-wide elections This assembly, charged with the responsibility of writing a new constitution, succeeded in producing a document reminiscent of the 1891 Constitution but with significant changes in evidence. Brazil's second federal constitution was officially promulgated on July 16, 1934 but was to have a life span of little more than three years.[9]

The Distribution of Functional Authority

The new distribution of functional authority con contained in the 1934 Constitution reflected a basic change

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[9]The text of the Constitution of 1934 may be found in *Ibid.*, pp. 229-336.

in the philosophy governing the role of the State. While the 1891 Constitution was influenced by the tenets of nineteenth century liberalism, the new constitution foresaw a greater role for the public sector, especially in economic and social affairs. Karl Loewenstein refers to its philosophy as "a vague socialism . . . rooted in the paternalistic habits of the Empire and blended with the liberal residues of the republic."[10]

The Federal Government

In legal terms, the federal government undoubtedly gained in relative power as a result of the 1934 Constitution. The circumstances under which the national government could intervene in the affairs of the states were somewhat narrowed, but additional responsibilities delegated to the former were substantial. Since residuary powers, as before, were delegated to the states, the increases in the functional authority of the federal government necessarily came at the expense of state powers.

The increased social and economic role of the public sector is clearly revealed in Article 5, which lists those powers exclusively reserved to the federal government. Of special interest in this respect are the powers to establish

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[10]Karl Loewenstein, *Brazil Under Vargas* (New York: Macmillan Company, 1942), p. 24.

a national plan of highways and railroads (Section 9), to supervise the national educational system (Section 14) and to organize a permanent defense against the effects of the drought in the northeastern states (Section 15).[11] In the same Article (Section 19, Paragraphs h and i), the federal government is delegated the exclusive power to legislate on foreign and interstate commerce, foreign exchange, general norms for labor, production and consumption and national resources.

The nature of these exclusive powers is elaborated upon in other parts of the document. Provisions pertaining to the "economic and social order," for example, are enumerated in Title IV. Here one finds passages referring to the federal monopolization of certain economic activities (Article 116); the nationalization of banks of deposit, mines and sources of hydroelectric power (Articles 117 and 118); the promotion of production and the regulation of labor conditions (Article 121 and others); the regulation of agriculture and the promotion of agricultural colonies (Article 121); and the organization of a national health service for combatting endemic diseases (Article 140).

The increased role of the federal government in the area of education is revealed in Title V, Chapter II.

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[11]To finance this latter scheme, the federal, state and municipal governments were to earmark 4 per cent of their respective tax revenues (Article 177).

Although the states and the federal district were to organize and maintain their respective educational systems (Article 151), they were to do so only within the norms outlined by the national government (Article 150). Furthermore, the states and the federal district were obliged to apply no less than 20 per cent of their tax revenues to the development and maintenance of their educational systems (Article 156).

The States and Municipalities

As mentioned previously, the states lost relative power as a result of the 1934 Constitution. They were still free to perform all residuary functions, but federal gains in the areas of education, natural resources, public health, social welfare and labor had significantly narrowed their sphere of action. Article 10 stated that the federal government and the states were to exercise concurrent authority over such functions as public health and assistance, colonization and public instruction, but national directives in these areas severly restricted state autonomy.

The municipalities, on the other hands, had their position considerably strengthened by the 1934 Constitution. These administrative units were formally recognized as viable members of the federal system and were freed from much of the national and state control to which they had

previously been subjected. The Constitution provided for local election of officials, local organization of public services and, probably most importantly, exclusive revenue sources (Article 13).

The Distribution of Revenue Sources

In addition to revising the relative distribution of functional authority, the Constitution of 1934 substantially changed the division of revenue sources among the three main administrative units. The balance of power, once again, moved against the states.

Two new financial criteria were contained in this document. These were: (1) a limitation of concurrent jurisdiction over revenue sources between the national government and the states and (2) a definition of the power of the municipalities to levy exclusive taxes.[12] With respect to the former criterion, Article 11 held that in the case of overlapping taxation the tax levied by the federal government would prevail.

Table 3 lists the exclusive revenue sources delegated to the federal government (Article 6), the state governments (Article 8) and the municipalities (Article 8).

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[12]Amilcar de Araújo Falcão, *Sistema Tributário Brasileiro* (Rio de Janeiro: Edições Financeiras, S. A., 1965), pp. 35-36.

TABLE 3

Division of Exclusive Revenue Sources in the Constitution of 1934

Federal	State	Municipal
Tax on Imports	Tax on Rural Land Property	Licence Tax
Consumption (Excise) Tax[a]	Tax on the Transfer of Property *causa mortis*	Tax on Urban Land and Buildings
Income Tax[b]	Tax on the Transfer of Real Property *inter vivos*	Tax on Public Amusements
Tax on the Transfer of Funds Abroad	Consumption (Excise) Tax[c]	Tax on the Income of Rural Real Property
Stamp Taxes	Tax on Sales and Consignments	Fees from Municipal Services
Fees from Federal Services	Tax on Exports[d]	
	Tax on Industries and Professions[e]	
	Stamp Taxes	

[a]Except on fuels for combustion engines.

[b]Except on income from rural real property.

[c]On fuels for combustion engines.

[d]Up to 10 per cent *ad valorem*.

[e]To be shared on a 50-50 basis with the municipalities.

As can be noted from a comparison of Tables 2 and 3, the federal government experienced a major fincncial gain by obtaining the exclusive right (with the noted exceptions) to levy the lucrative income and excise taxes. The states gained the exclusive right to levy sales taxes but lost the power to tax urban real estate to the municipalities. Furthermore, the states were now required to share the proceeds from the tax on industries and professions with the municipalities on a 50-50 basis (Article 8, Section 2, Paragraph 2). This provision marked the beginning of formal tax sharing in Brazil, a method of intergovernmental fiscal cooperation which would be increasingly utilized in future constitutions. The municipalities, of course, were delegated exclusive revenue sources for the first time by a national constitution.

Three other provisions of the 1934 Constitution served to further erode the financial autonomy of the states. Two of these provisions, moreover, tended to mitigate the new financial autonomy of the municipalities. The first of these provisions concerned the ability of the national government and the states to levy taxes other than those expressly delegated to them by the Constitution. Although this action was permitted through Article 10, Section VII, teses taxes were to be collected by the states and then shared with the federal government and the municipalities

on a 30-20 basis respectively. The states would retain the residual 50 per cent. The provision further stipulated, however, that should the states become delinquent in the payment of these quotas, the federal government would be entitled to levy and collect such taxes. The sharing of the revenues would then be on a 30-20 basis with respect to the states and municipalities. The federal government would retain the residual 50 per cent. The effect of Article 10, Section VII, then, was to sharply dampen the incentive of the states to levy new taxes.

Another constitutional stipulation which narrowed the financial power of the states as well as that of the municipalities was contained in Article 17, Section IX. The provision prohibited the collection of interstate and intermunicipal taxes on the grounds that they impeded the free circulation of goods, persons and vehicles of transportation. Since many states had liberally interpreted their previous constitutional right to tax exports as pertaining to goods shipped to foreign destinations *and* to other states, the new prohibition of the latter type of taxation resulted in a severe financial loss to those states which had been highly dependent on them as a revenue source.[13]

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[13]The debate over interstate taxation of commerce during the First Republic is described in detail in Chapter IV.

A final constraint on the financial power of the states and municipalities concerned their freedom to sell debt. In Article 19, Section V, the states, the federal district and the municipalities were prohibited from contracting foreign loans without prior authorization from the Federal Senate. Although this stipulation intended to curb the abuses of public credit (by both the contracting parties and the creditors) experienced during the tenure of the 1891 Constitution, it must be interpreted as a direct interference with the autonomy of the affected administrative units.[14]

The Constitution of 1937

The political, as well as financial, autonomy of the states and municipalities was completely abridged by the coup d'état of November 10, 1937. Led by Vargas with the support of the military, the overthrow of constitutional government virutally destroyed any semblance of federalism in Brazil. Although a new constitution was promulgated on the day of the coup, it was a "ghost constitution" which served only to outline the social and economic aims of a complete Vargas dictatorship. This dictatorship, known as

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[14]The extent and problems of foreign borrowing by the states and municipalities is discussed in Chapter IV.

the *Estado Nôvo* (New State), molded Brazil into a corporate state on the order of Fascist Italy and Germany.[15]

As suggested by Loewenstein, the nature of the Constitution of 1937 is best understood by reading its final Articles first. In Article 187, it was stated that the Constitution was to go into effect immediately, but would be submitted to a national plebiscite to be held at some later date as arranged by the President. In Article 186, a state of emergancy was declared during which the Constitution was to be suspended. Furthermore, all acts or decrees undertaken during the state of emergency were beyond the jurisdiction of the courts.

Since the constitutional provision declaring a perpetual state of emergency could only be removed through amendment, the sections dealing with the election of a National Congress are of special interest.[16] This is because the amending process required a majority vote of the Chamber of Deputies and the Federal Council (Article 174). A National Congress, however, could only be elected after the Constitution had been submitted to and accepted by the

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[15]The text of the Constitution of 1937 may be found in Almeida, *Constituições do Brasil*, pp. 414-561. Perhaps the best legal analysis of the document in English is in Loewenstein, *Brazil Under Vargas*, pp. 116-58 *et passim*.

[16]The Congress had been dissolved by Vargas on the day of the coup.

plebiscite (Article 178). In an apt analogy, Loewenstein referred to this situation as a "constitutional cat . . . chasing its legal tail . . ."[17] A national plebiscite was, in fact, never held and the Constitution came to be amended by a series of "constitutional laws" decreed by Vargas.

The Distribution of Functional Authority

In a nation characterized by a dictatorship as pervasive as the Estado Nôvo, it is perhaps meaningless to speak of a division of functional authority among the several administrative units. When supreme power rests with the president, the delegation of authority to the states and municipalities serves only to decentralize a basically unitary situation. The Constitution of 1937 does, however, offer some insight into the socio-economic goals and philosophy of the Vargas regime and in this respect deserves some attention.

The Federal Government

The Constitution of the Estado Nôvo represented an extension of the political, social and economic philosophy contained in its immediate predecessor. Emphasis was on the paternal role of the State, especially with respect to the

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[17]Loewenstein, *Brazil Under Vargas*, p. 47.

family, the worker and the poor. In fact, much of the 1937 Constitution is devoted to an exposition of the State's obligations to these groups. The federal government (meaning Vargas himself), was to be the primary enforcer of these gruidlines.

In Articles 124-127, the family is declared to be under the special protection of the State with the care of infancy and youth being of foremost importance. Articles 128-134 hold the State responsible for the development and stimulation of art, science and education. With respect to the latter, the State was obligated to assist or create artistic, scientific and educational institutes.

The section concerning the "economic order" encompasses Articles 135-155. Here one finds provisions referring to the role of the public sector in the economy, labor conditions and foreign enterprise. The basic tenor of the section is capitalistic with nationalistic overtones. Although private enterprise was encouraged, the intervention of the State was held to be justified to make up for "deficiencies of individual initiative and to coordinate the factors of production . . ." (Article 135).

Articles 136-141 outlined a "progressive" public policy toward labor. In these provisions, certain aspects of labor conditions such as the eight-hour day, medical assistance, minimum wages and unionization were recognized

by the government. Strikes and lock-outs, however, were declared to be "anti-social" and "incompatible with the superior interests of national production" (Article 139).

Most of the rest of the section dealing with the "economic order" was devoted to a listing of guidelines pertaining to foreign investors in Brazil. Foreigners, for example, were prohibited from utilizing the wealth of the subsoil (Article 143). Furthermore, foreign concessions already existing in mining and other essential industries were to be progressively converted to Brazilian ownership (Article 144). Finally, certain stipulations were included which outlined the professions which were exclusively reserved to Brazilians and others which had to employ a specified percentage of nationals.

In sum, then, the Brazilian national government greatly extended its sphere of authority in line with the trend begun with the coming to power of Vargas in 1930. Centralization of responsibilities was especially pronounced in the social and economic areas through the Constitution of 1937. Indicative of this centralization was the removal of the provision in the Constitution of 1934 which called for the earmarking of tax revenues for drought relief in the northeastern states.

The States and Municipalities

In line with previous Brazilian constitutions, the Constitution of 1937 reserved residuary powers to the states. During the Estado Nôvo, however, this provision had practically no real meaning. Not only had the federal government carved out large areas of public responsibility for itself, but the activities which were carried on by the states were carefully supervised by Vargas. The Constitution did provide that the states could legislate in the areas of mining, hydroelectric energy, public health, agricultural credit and others, but only when such action would not interfere with the policies of the national government.

The President's control over the states during the 1937-45 period was manifested through a system of Interventores and Administrative Departments.[18] The former system, which had been previously used by Vargas during the 1930-34 period, consisted of presidentially appointed acting governors. Administrative Departments, consisting of four to ten members, existed in every state and exerted a check on the activities of the Interventor. Both the Interventores and the Administrative Departments, however, were under the supervision of the Minister of Justice, who was in turn appointed by the President. Through this control mechanism,

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[18] *Ibid.*, pp. 59-70.

the states became little more than the regional administrative arms of the national government.

Although assured autonomy "in everything with respect to their peculiar interest" by Article 26 of the Constitution, the municipalities became little more than the local administrative arms of the national government. Each municipality was governed by a mayor (prefeito) appointed by the Interventor of the state and was also controlled by the respective Administrative Department. In short, both the states and municipalities, while still performing some public functions of a regional and local character, retained virtually no political autonomy.

The Distribution of Revenue Sources

The distribution of revenue sources in the Constitution of 1937 also reflected the centralizing tendencies of the Estado Nôvo. The division of exclusive revenue sources, as outlined in Articles 20, 23 and 28 of the document, is presented in Table 4. By comparing Tables 3 and 4, it appears that there is little difference between the financial provisions of the 1934 and 1937 Constitutions, but closer scrutiny reveals that both the states and municipalities lost relative power.

First of all, the states were deprived of their right to levy taxes on the consumption of fuels for

TABLE 4

Division of Exclusive Revenue Sources in the Constitution of 1937

Federal	State	Municipal
Tax on Imports	Tax on Rural Land Property	Licence Tax
Consumption (Excise) Tax	Tax on the Transfer of Property *causa mortis*	Tax on Urban Land and Buildings
Income Tax	Tax on the Transfer of Real Property *inter vivos*	Tax on Public Amusements
Tax on the Transfer of Funds Abroad	Tax on Sales and Consignments	Fees From Municipal Services
"Single Tax" on Fuels and Liquid Lubricants[a]	Tax on Exports[b]	
Stamp Taxes	Tax on Industries and Professions[c]	
Fees from Federal Services	Stamp Taxes	
	Fees From State Services	

[a]Instituted through Constitutional Law 4 (September, 1940) to be shared among the federal, state and municipal governments on a 40-48-12 basis, respectively.

[b]Up to 10 per cent *ad valorem*.

[c]To be shared on a 50-50 basis with the municipalities.

combustion engines. This provision now enabled the federal government to have complete jurisdiction over excises. Secondly, the right of the municipal governments to tax the income from rural real property was abolished. Thirdly, the provision that the municipalities would obtain a 20 per cent share of new taxes was removed, thus giving the federal government somewhat greater leeway in the imposition of additional taxes. Finally, the wording of the Constitution referring to the right of the national government to tax contracts regulated by federal law was altered slightly for the ostensible purpose of broadening its incidence.

Although the financial pattern of the Constitution of 1937 was clearly centralizing, a major step in the area of tax sharing was taken in 1940. Through Constitutional Law 4 (in effect a constitutional amendment) the "*impôsto único*" (single tax) on fuels and liquid lubricants was passed, the revenues of which were to be divided among the federal, state and municipal governments.[19] According to the scheme for dividing these funds, the municipal system was to receive 12 per cent of the total, the states 48 per

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[19]In describing this so-called "single tax" on fuels and combustible products, Carl S. Shoup states that it is "in fact a collection of taxes at various rates on these items, but is 'single' in the sense that no other taxes, not even state and municipal taxes, are imposed on them" From Carl S. Shoup, *The Tax System of Brazil* (Rio de Janeiro: Fundação Getúlio Vargas, Commisão de Reforma do Ministério da Fazenda, 1965), p. 70.

cent and the federal government the remaining 40 per cent. Distribution of the quotas to the states and municipalities was to be made in accordance to the consumption of taxable items in their respective territories. It was further stipulated that the proceeds from these funds were to be applied to the maintenance of state and local road networks.

The Constitution of 1946

As World War II ended, the Brazilian people began to express their impatience over the absence of the national elections long promised by Vargas. Although Vargas continued to pledge that free elections would soon be held, his increasing hesitancy on this matter prompted the military to depose him in 1945. As a result, national, state and local elections were finally held and a new constitution was promulgated on September 18, 1946.[20]

The Constitution of 1946, which ushered in a period of democratic government previously unknown in Brazil, was very similar to the constitution of 1934 "although without many of its defects and with new virtues. . . ."[21] The tenor

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[20]The text of the Constitution of 1946 may be found in Almeida, *Constituições do Brasil*, pp. 596-711. For an English language translation see *Constitution of the United States of Brazil—1946*, (Washington, D. C.: Pan American Union, 1963).

[21]Paulo Sarasate, *A Constituição do Brasil ao Alcance de Todos* (2nd ed.; Rio de Janeiro: Livraria Freitas Bastos, S. A., 1967), p. 19.

of the 1946 Constitution was a mixture of nineteenth century liberalism and the modern interventionist state. Basically a reaction against the extreme centralization of the Estado Nôvo, the new document nevertheless retained much of what had been instituted during the period of Vargas' dictatorship.

According to Gilberto de Ulhôa Canto, the Constitution of 1946 "was characterized by a double purpose: decentralization and the strengthening of the position of the municipalities."[22] Sentiment for greater autonomy at the grass roots level was strong among the writers of the constitutional draft and the document which they produced has often been referred to as "municipalist."

The Distribution of Functional Authority

The functions delegated to the three main administrative units in the Constitution of 1946 actually changed very little from that of the 1934 and 1937 Constitutions. Like the 1934 Constitution, however, the 1946 Constitution provided for *political* autonomy at the state and municipal levels.[23] The methods of federal control

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[22]Gilberto de Ulhôa Canto, "Study of the Brazilian Tax System in View of the Federal Regime," *Bulletin for International Fiscal Documentation*, III (1949), 86.

[23]Themístocles Brandão Cavalcanti, *Manual da Constituição* (2nd ed.; Rio de Janeiro: Zahar Editores, 1963), pp. 68-69.

over these latter units during the Estado Nôvo, including the Interventor system and the Administrative Departments, were abolished and state and locally elected officials were substituted in their place.

The Federal Government

The federal government essentially retained the same role it had been assigned in the two preceding constitutions. Public authority remained strong in the economic and social areas, although some of the objectionable directives of the Estado Nôvo were repealed. In the general field of labor, for example, the Constitution of 1946 recognized the right of workers to strike (Article 158) while maintaining the guidelines on labor conditions included in the Constitutions of 1934 and 1937. In addition, the new Constitution provided for compulsory profit sharing plans (Article 157, Section IV) and voluntary retirement at full pay for all public employees with a minimum of thirty-five years of service (Article 191, Section II).

The amalgam of philosophies contained in the 1946 Constitution is perhaps most clear in the part of the document dealing with the "economic and social order." While freedom of initiative was encouraged (Article 145) and abuses of economic power were discouraged (Article 148), federal intervention in the economy and the creation of

public monopolies were deemed permissible (Article 146).[24] Furthermore, a National Economic Council was instituted "to study the economic life of the country and to suggest to the competent authority such measures as it deems necessary" (Article 205).

Interest in regional economic development was renewed in the 1946 Constitution after being given a low priority during the Estado Nôvo. To this end, the Constitution provided for a minimum of 3 per cent of the federal tax revenues to be earmarked for combatting the drought in the Northeast, with one-third of these revenues to be deposited in a special fund for loaning to farmers and industrialists in the affected areas (Article 198). The states in the region were obliged to expend 3 per cent of their revenue on a complementary basis for the construction of dams and other forms of assistance to their respective populations.

The São Francisco River Valley was also singled out for special treatment in the 1946 Constitution. (Transitory Provisions, Article 29). This river system, winding through the eastern and northeastern regions of Brazil, was to be developed according to a plan which would be financed through the earmarking of not less than 1 per cent of the federal

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[24] *Ibid.*, pp. 230-45.

tax revenues. Finally, the Constitution provided that a plan for the development of the Amazon Region would be executed, financed through the earmarking of not less than 3 per cent of the federal tax revenues for twenty consecutive years (Article 199). The states, territories and municipalities of the region were to contribute 3 per cent of their respective tax revenues for the same purpose. The federal government, however, was authorized to dispense these funds.

The States and Municipalities

The primary gains of the states and municipalities through the 1946 Constitution were the guarantees of political autonomy, not increased responsibilities. As mentioned previously, both levels of government were to have their officials elected by popular vote and were free to organize their services with a minimum of interference from any other administrative unit. The municipalities were substantially aided in exercising this new political autonomy, however, by their improved financial position.

The Distribution of Revenue Sources

The division of revenue sources contained in the 1946 Constitution represented a major change from that included in previous constitutions. Not only were the types

of taxes delegated to the three administrative units altered, but extensive new tax-sharing arrangements were implemented. The former is shown in Table 5.

The revenue sources reserved to the federal government (Article 15) exhibited little change as compared to the Constitution of 1937 (see Table 4) although the base of the "single tax" on fuels was somewhat expanded by the inclusion of gaseous fuels, minerals and electricity in the taxable category. The states, however, appeared to incur significant financial losses as a result of the 1946 Constitution. First of all, they were denied the tax on industries and professions which was to be turned over to the jurisdiction of the municipalities (the municipalities had previously been receiving 50 per cent of the proceeds from this tax on a sharing basis with the states). Secondly, the states were prevented from levying export duties in excess of 5 per cent *ad valorem* (under the 1934 and 1937 Constitutions, the limit had been 10 per cent).[25] Finally, as a result of Constitutional Amendment 5 (1961), two taxes were transferred from the jurisdiction of the states to that of the municipalities. These were the taxes on rural land property and the transfer of real property *inter vivos*.

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[25]The federal Senate, however, could authorize an increase in this tax up to 10 per cent *ad valorem* in exceptional cases (Article 18, Section VI, Paragraph 6).

TABLE 5

Division of Exclusive Revenue Sources in the Constitution of 1946 (Pre-1964)

Federal	State	Municipal
Tax on Imports	Tax on Rural Land Property[a]	Tax on Urban Land and Buildings
Consumption (Excise) Tax	Tax on the Transfer of Property *causa mortis*	License Tax
"Single Tax" on Liquid and Gaseous Lubricants, Fuels, Electric Energy and Minerals	Tax on the Transfer of Real Property *inter vivos*[b]	Tax on Industries and Professions
Income Tax	Tax on Sales and Consignments	Tax on Public Amusements
Tax on the Transfer of Funds Abroad	Tax on Exports[c]	Stamp Taxes
Stamp Taxes	Stamp Taxes	Fees
Fees	Fees	Special Assessments
Special Assessments	Special Assessments	

[a]Transferred to municipal jurisdiction through Constitutional Amendment 5 (November, 1961).

[b]Transferred to municipal jurisdiction through Constitutional Amendment 5.

[c]Up to 5 per cent *ad valorem*.

The municipal system appeared to have been the prime beneficiary of the new distribution of revenue sources. Besides gaining the full proceeds of the tax on industries and professions and the taxes on rural land property and the transfer of real property *inter vivos* (through Amendment 5), the local governments also increased their share in the proceeds from any new taxes created. Formerly 20 per cent, the municipalities were not entitled to a 40 per cent share; the federal government's share thus falling to 20 per cent (Article 21). This stipulation had the effect of discouraging the federal government from extending its tax jurisdiction through the creation of new taxes. The municipalities, however, probably benefited to the greatest extent from the tax-sharing arrangements of the 1946 Constitution.

Tax Sharing

The sharing of tax proceeds among the administrative units was greatly expanded in the Constitution of 1946 and in its subsequent amendments. Although not new to the Brazilian fiscal system, the tax-sharing arrangements in the 1946 document were used for the avowed purpose of strengthening the financial position of the municipalities. In this respect, the "municipalist" tenor of the Constitution is perhaps most clearly revealed.

Table 6 lists the tax-sharing provisions of the 1946 Constitution. As can be noted, the sharing of federal tax revenues with the states remained essentially unchanged from the 1940 Amendment of the 1937 Constitution. The only difference between the new arrangement and the previous one was that the base of the "single tax" was somewhat expanded in the 1946 Constitution. The 12 per cent share of the "single tax" to be distributed to the municipalities was likewise retained. Two more important tax-sharing arrangements between the federal government and the municipalities, however, were included.

First of all, it was stipulated (Article 10, Section VI, Paragraph 4) that 10 per cent of the federal income tax revenues were to be turned over to the municipalities (those of state capitals excepted) to be distributed among them in equal parts. It was further provided that at least half of the amount of these quotas was to be "applied to benefits of a rural nature." Through Amendment 5, the income tax quota was raised to 15 per cent and was extended to include the municipalities of state capitals. Amendment 5 also clarified what was meant by the phrase "benefits of a rural nature." Such benefits were deemed to be "services that are installed, or works carried out to improve the economic, social, sanitary, and cultural

TABLE 6

Tax-Sharing Arrangements in the Constitution of 1946 (Pre-1964)

Governmental Levels Involved	Specific Arrangements
Federal Government with the States:	48 per cent of the "single tax" on liquid and gaseous lubricants, fuels, electric energy and minerals.
Federal Government with the Municipalities:	10 per cent of the income tax (excluding state capitals).[a]
	10 per cent of the consumption (excise) tax.[b]
	12 per cent of the "single tax" on liquid and gaseous lubricants, fuels, electric energy and minerals.
States with the Municipalities:	30 per cent of the state taxes collected in a municipality in excess of the total income of the municipality.[c]

[a]The quota was raised to 15 per cent and was broadened to include state capitals through Amendment 5 (November, 1961).

[b]Instituted through Amendment 5.

[c]The export tax was to be excluded from the sum of state revenues and the capital cities were to be excluded from the state subsidy.

conditions of the rural population" (Constitutional Amendment 5, Article 15, Paragraph 6).

Amendment 5 also granted a 10 per cent share of the federal consumption (excise) tax to the municipalities (Article 15, Paragraph 4). The distribution of these funds was to be in equal parts payable in the last quarter of each year. This new tax-sharing device was perhaps the most significant provision of the Amendment, since the excise taxes represented the most lucrative source of federal income at the time. As a result, the potential for the expansion of local public services, especially among the poorer municipalities, was greatly increased.

A final tax-sharing scheme concerned a flow of revenues from the states to the municipalities. According to Article 20 of the 1946 Constitution, when the state taxes collected in a municipality exceeded the total income of this municipality from any source, 30 per cent of the excess would be returned to the local government. The only further stipulation in this respect was that the state export tax to be excluded from the sum of state revenues and that the capital cities be excluded from the state subsidy.

Summary

In legal terms, the nature of Brazilian fiscal federalism underwent substantial changes between 1889 and 1964. While the overall trend exhibited an increasing role for government in general, the three administrative units did not share equally in this expansion of public authority.

The Constitution of 1891, Brazil's first as a federal republic, was imbued with the philosophy of nineteenth century liberalism. Conforming to the laissez-faire tenets of liberalism, very few specific functions were assigned to the public sector other than administration and defense. Since all residuary powers were reserved to the states, the performance of most public functions became very decentralized. In this decentralization, the states took the dominant role since the municipalities, although guaranteed autonomy, were not guaranteed any specific revenue sources.

Brazil's next Constitution, promulgated in 1934, represented a major change in philosophy from its predecessor. The new Constitution did maintain some of the liberal influences of the First Republic, but also encompassed the philosophy of the interventionist state. No doubt influenced by Germany's Weimar Constitution of 1919, the Constitution of 1934 revealed an economic and social

content that stood in sharp contrast to the purely political content of the Constitution of 1891.[26] The 1934 document assigned a greater role to the federal government, but also clearly defined municipal autonomy. The municipalities were granted exclusive revenue sources for the first time and were expected to become viable members of the federal system.

The short-lived Constitution of 1934 was replaced by a distinctly centralist constitution in 1937. The federal structure of Brazilian government was destroyed and superceded by a corporate structure reminiscent of Fascist Italy and Germany. Although lip service to state and local autonomy was included in the document, real control of the nation emanated from the President of the Republic, Getúlio Vargas. The paternalistic role of the state which characterized the Constitution of 1934 was accentuated during the Estado Nôvo but within the framework of Vargas' personal dictatorship.

The Constitution of 1946 marked Brazil's return to democratic government. The extreme centralization of the Estado Nôvo was relaxed, although fifteen years of Vargas rule had apparently made a lasting impression. Most of the constitutional provisions pertaining to economic and

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[26]Cavalcanti, *Manual da Constituição*, pp. 25 and 37.

social matters which had been instituted during the Vargas regime were retained, but without the political controls over the states and municipalities. The financial provisions of the 1946 Constitution also reflected a desire to retreat from the centralization of the 1930-45 period. In this respect, the Brazilian municipal system benefited greatly since they received new exclusive revenue sources as well as shares of the productive federal income and excise taxes.

CHAPTER IV

BRAZILIAN FISCAL FEDERALISM IN PRACTICE (1): THE FIRST REPUBLIC, 1889-1930

The Brazilian public sector has undergone numerous changes since its conversion to the federal form at the end of the nineteenth century. The years between the advent of the First Republic and 1930 witnessed the transformation of Brazil from a rather loose regionalism to a strong dictatorship, economic boom and bust and the rise of a new urban industrial class. Each of these occurrences had a strong impact on the nation's public finances.

In this and the following three chapters, Brazilian fiscal federalism will be examined in an effort to ascertain the relationship between the purely legal norms of public finance described in the previous chapter and the interpretation of these laws in practice. To this end, substantial use of public finance statistics will be made.

Political and Economic Division of Power

By Administrative Level

The years of the First Republic were characterized by what has been termed "dualist federalism" (*federalismo dualista*), since the only meaningful intergovernmental

relationships during this time were between the federal government and the states.[1] Throughout the 1889-1930 period, the most substantial administrative entities in the public sector, both economically and politically, were the national government, the states of São Paulo and Minas Gerais, and to a lesser extent, the state of Rio Grande do Sul.[2] At the municipal level, power rested in the hands of local élite or "*coronéis*" (colonels).[3] These men, often large landowners, usually worked out a reciprocal agreement with their respective state governments whereby one would recognize and support the other.[4]

By Region

In the latter part of the nineteenth century, the declining world market for sugar and the abolition of

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[1]Raul M. Horta, "Problemas do Federalismo," *Perspectivas do Federalism Brasileiro* (Belo Horizonte: Imprensa da Universidade de Minas Gerais, 1958), p. 24.

[2]The Brazilians "dubbed their system, with reference to the State factions which predominated in central policy, *a política dos gobernadores;* or better still, in allusion to the coffee plantations of São Paulo and the cattle herds of Minas Gerais, *a política de café com leite*." From Leslie Lipson, "The Federal Principle and the Brazilian Reality," *Public Policy,* XIV (1965), 447.

[3]The name "colonel" was a title of respect given to these men even though they may have never held an actual military commission, much like our own "Kentucky colonels."

[4]Víctor Nunes Leal, *Coronelismo, Enxada e Voto: O Município e o Regime Representivo no Brasil* (Rio de Janeiro, 1948), pp. 25-26.

slavery had dealt a crushing blow to the long-standing dominance of Brazil's Northeast. The resultant shift of political and economic power to the Center-South (the combined southern and eastern regions) emanated primarily from the burgeoning world coffee market and the rise of a wage-earning sector.[5] Although most of the direct benefits of the coffee economy flowed to the state of São Paulo, the states of Minas Gerais and Rio Grande do Sul indirectly benefited from the expanding internal market for their production of livestock and agricultural commodities.

The republican decentralization itself also produced conditions which strengthened the position of the southern coffee planters. First of all, the new republican government passed monetary reform which granted the right of currency issue to several regional banks. The resulting expansion in credit "brought twofold benefit to the coffee-grower class, providing it with the necessary credit for financing the opening of new land and raising coffee prices in local currency through exchange depreciation."[6] In

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[5]For more detail on this trend see Celso Furtado, *The Economic Growth of Brazil: A Survey From Colonial to Modern Times*, trans. by Ricardo W. de Aguiar and Eric C. Drysdale (Berkeley: University of California Press, 1964), pp. 148-203. With respect to the effects of abolition, Furtado interestingly points out that "slavery was more important as the basis of a regional system of power than as a form of organization of production," p. 154.

[6]*Ibid.*, p. 193.

addition, the states were now able to undertake tasks, such as public works projects, long left undone by the central government. Some states even initiated programs to encourage immigration and artifically restrict the supply of coffee.[7]

Public Financial Patterns

By Administrative Level

The federal government appeared to be the most important fiscal agent among the three administrative levels during the first four decades of the Brazilian federation. The following table illustrates this point. However, when considering the relative financial importance of the states and municipalities it must be kept in mind that the financial powers of the municipalities were derived from those of the states and were limited by the constitution and state laws.[8] In effect, the states and the municipalities were one fiscal unit; the latter being merely the local fiscal agent

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[7]The state of São Paulo led the early movement to encourage immigration. T. Lynn Smith notes that "to the systematic recruiting of agricultural workers by São Paulo and the subsidization of their movement across the ocean, Brazil owes the lion's share of her immigration." From Smith, *Brazil: People and Institutions*, pp. 118-19.

São Paulo also pioneered in the formulation of price supports for coffee. For a discussion of these early "valorization" programs see Furtado, *Economic Growth of Brazil*, pp. 193-97 and O. K. Moore, "The Brazilian Coffee Economy" (Ph. D. dissertation, University of Florida, 1962), pp. 210-27.

[8]Leal, *Coronelismo*, p. 108.

of the former. Thus in reality the fiscal, as well as the political-administrative, aspects of the early federal period were "dualist" in nature.[9]

Table 7 shows a tendency for the federal government's financial importance to decline in relative terms during the 1907-30 period. The consequent relative growth of the states and municipalities can be traced to many factors such as the productivity of the revenue sources delegated to the states, the rapid enlargement of public services at the state level and the widespread incurring of debt (causing both an increase of revenues and an increase in expenditures for interest and amortization payments). Each of these factors will be discussed in greater depth in subsequent sections of the present chapter.

By Region

Besides being "dualist," the financial pattern of the First Republic was clearly regional. As in the political-administrative and economic spheres, the central-

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[9]It should be pointed out, however, that the revenue sources delegated to the municipalities by their respective state governments varied considerably from state to state. In Rio Grande do Sul, for example, local governments were allowed relatively few exclusive revenue sources while in Amazonas, Sergipe and Rio Grande do Norte just the opposite case was true. For more information on this topic see José de Castro Nunes' *Do Estado Federado e sua Organização Municipal* (Rio de Janeiro: Leite Ribeiro & Maurillo, 1920) and *As Constituições Estaduaes do Brasil* (Rio de Janeiro: Leite Ribeiro, 1922).

TABLE 7

Revenues and Expenditures by Administrative Level as a Percentage of the Totals Collected and Spent by the Public Sector, Selected Years, 1907-30

Years	% of total revenues			% of total expenditures		
	Federal	State	Municipal	Federal	State	Municipal
1907	65.8	22.1	12.1	63.6	23.5	12.9
1910	59.5	22.0	18.5	62.0	22.7	15.3
1915	51.3	30.9	17.8	63.2	23.0	13.8
1920	59.6	27.9	12.5	65.5	23.4	11.1
1925	56.6	30.7	12.7	55.8	30.8	13.4
1930	51.2	31.0	17.8	54.1	32.0	13.9

Source: Adapted from Brazil, IBGE, *Anuário Estatístico—1939/40*, p. 1409.

southern states were the most important fiscally. Table 8 shows the relative positions of São Paulo, Minas Gerais and Rio Grande do Sul with respect to total state revenues and expenditures. As the data indicate, these three states dominated the other seventeen in fiscal terms; averaging about 69 per cent and 68 per cent, respectively, of total state revenues and expenditures during the last three years of the First Republic. In contrast, such important northeastern states as Bahia and Pernambuco averaged only about 5 per cent each of total state revenues and expenditures during the same period.[10]

In per capita terms, the finances of São Paulo, Minas Gerais and Rio Grande do Sul were also the leaders among the states. Table 9, which groups the six most populous states of Brazil in order of population size in 1930, offers further proof that the public sectors of the central-southern states were more developed than those of states in other regions. The low per capita revenues and expenditures of Bahia and Pernambuco are consistent with their low relative positions among total state revenues and expenditures.

As might be expected, the relative size of municipal revenues and expenditures was also related to their respective regions. In 1930, the combined municipal revenues

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[10]Brazil, IBGE, *Anuário Estatístico—1939/40*, p. 1416.

TABLE 8

Revenues and Expenditures of São Paulo, Minas Gerais and Rio Grande do Sul as a Percentage of the Totals Collected and Spent by the States, 1897-1930

Years	% of total state revenues			% of total state expenditures		
	São Paulo	Minas Gerais	Rio Grande do Sul	São Paulo	Minas Gerais	Rio Grande do Sul
1897-1906	29.3	10.6	6.3	29.2	12.3	10.0
1907-1916	30.4	13.4	8.0	35.4	12.5	12.3
1917-1926	34.5	14.9	12.5	39.2	16.3	12.5
1927-1930	37.5	16.0	15.3	42.0	14.2	12.0

Source: Adapted from Brazil, IBGE, *Anuário Estatístico—1939/40*, p. 1416.

TABLE 9

Per Capita State Revenues and Expenditures in Six Selected States, 1930, (in milréis)[a]

States	Revenue Per Capita	Expenditure Per Capita
Minas Gerais	20.3	37.9
São Paulo	68.0	104.7
Bahia	14.8	21.1
Rio Grande do Sul	58.8	65.2
Pernambuco	19.5	20.8
Rio de Janeiro	18.4	43.9

Source: Computed by the author on the basis of revenue and expenditure data in Brazil, IBGE, *Anuário Estatístico—1939/40*, pp. 1413-15 and population data in Brazil, Departamento Nacional do Café, *Atlas Estatístico do Brasil* (Rio de Janeiro, 1941), p. 21.

[a]A milréis was worth about U. S. $.10 in 1930.

and expenditures of São Paulo, Minas Gerais and Rio Grande do Sul comprised about 45 per cent of the totals for all municipalities.[11]

In addition to the regional nature of municipal finances there was, within given states, usually a wide dichotomy between the financial resources of the urban and rural municipalities. This tendency is especially to be noted in the state of São Paulo. In 1917, for example, the municipality of the city of São Paulo (the capital of the state of São Paulo) collected about 35 per cent of all municipal receipts and spent about 36 per cent of all municipal expenditures within the state.[12] At this time there were almost 200 municipalities in São Paulo. The 15,319 *contos de réis* (U. S. $3.8 million) of revenue collected by the capital city in 1917 can be compared to the 2 contos de réis (U. S. $725) collected by the rural municipality of Jatahy in the same year.[13]

This financial superiority of the capital city was also true in the state of Minas Gerais, although the degree of concentration was somewhat less than in São Paulo.

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[11] *Ibid.*, p. 1420.

[12] Brazil, São Paulo (State), Repartição de Estatística e Arcivo do Estado, *Annuário Estatístico de São Paulo—1917* (São Paulo, 1919), pp. 150-51.

[13] *Ibid.*, pp. 166-67.

In 1931, the municipality of Belo Horizonte (the capital of Minas Gerais) was collecting approximately 20 per cent of the total revenues of the state's 215 municipalities.[14]

The Problem of Regional Fiscal Adjustment

A fiscal problem common to all federations containing regions which differ greatly in their stages of economic development and income levels is the method of regional distribution of federal revenues and expenditures. The states with the highest levels of development and income offer a greater tax base for the national government to tap, while the poorer states are usually incapable of providing minimal levels of public services. The result of this problem is often for the richer states to bear the greater burden of national taxation while the poorer states get a dis-proportionately large share of the benefits from federal expenditures relative to their contribution. In the present section this question will be analyzed with respect to Brazil during the years of the First Republic.

Although income figures are not available for the early federal period, there is no doubt that Brazil's economic development was lopsided. This phenomenon has been cited earlier in the chapter, but the following

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[14]Menelíck de Carvalho, *A Revolução de 30 e o Município* (Rio de Janeiro: Departamento de Imprensa e Propaganda, 1942), pp. 148-52.

statistics serve to further document this contention. In 1920, the two states of São Paulo and Rio Grande do Sul and the Federal District (the city of Rio de Janeiro) accounted for 63.3 per cent of the value of the nation's industrial production; the state of São Paulo itself accounting for 31.5 per cent of the total. In contrast, the combined industrial production of nine northeastern states[15] accounted for less than 16 per cent of the national total.[16]

In agriculture, a group of seven central and southern states[17] and the Federal District accounted for 70.6 per cent of the national production in 1920.[18] In addition, the 1920 census shows that the farms in the states of São Paulo, Minas Gerais and Rio Grande do Sul alone represented approximately 65 per cent of the value of all farms in Brazil.[19]

The central and southern states also led in most other available indicators of development such as railroads,

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[15]Maranhão, Piauí, Ceará, Rio Grande do Norte, Paraíba, Pernambuco, Alagoas, Sergipe and Bahia.

[16]José Jobim, *Brazil in the Making* (New York: Macmillan Company, 1943), p. 96.

[17]Espírito Santo, Rio de Janeiro, Minas Gerais, São Paulo, Santa Catarina, Paraná and Rio Grande do Sul.

[18]J. F. Normano, *Brazil: A Study of Economic Types* (Chapel Hill: University of North Carolina Press, 1935), p. 13.

[19]*Ibid.*, p. 11.

highways, numbers of automobiles, electric power stations and value of exports.[20] In most cases, the subgroup of São Paulo, Minas Gerais and Rio Grande do Sul was the leader within the central-southern region.

Shortly after the beginning of the twentieth century arguments arose based on the contention that the central government showed favoritism in the regional distribution of its revenues and expenditures. The most vociferous group in these arguments were the Paulistas; largely in response to accusations made by people in the northern states that São Paulo was being developed by the federal government at their expense. The Paulistas argued the opposite case, that is, that the federal government was exploiting them to develop the rest of the country.

In 1921, Cincinato Braga, a state deputy from São Paulo, called attention to the growing contribution of his state to the national treasury. He noted that between 1889 and 1919 federal taxation in São Paulo had risen from 19,721 contos de réis to 128,209 contos de réis.[21] In 1933, Antoine Renard carried this analysis still further to show that São Paulo was not only providing huge sums of tax revenue

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[20] *Ibid.*, pp. 11-12.

[21] Cincinato Braga, *Problemas Brasileiros: Magnos Problemas Econômicos de São Paulo* (3rd ed.; Rio de Janeiro: Livraria José Olympio Editôra, 1948), pp. 19-20.

to the central government, but that it was receiving very little in return.[22]

Renard pointed out that of the 1,270,655 contos de réis of combined tax receipts (federal, state and municipal) collected in São Paulo in 1928, the share of the federal government was 56 per cent (approximately 700,000 contos de réis). In addition to this tax revenue the national government earned about 300,000 contos de réis from its enterprises in São Paulo, including the railroads, postal and telegraphic services and the federal shipping line.[23] In return for this 1 million contos de réis provided to the national treasury, the state received only 97,000 contos de réis in federal expenditures; a sum less than 10 per cent of its contribution.[24]

In contrast, it was pointed out that the states of Rio Grande do Sul and Minas Gerais contributed much less to the federal government, but received a much higher relative return. These two states, respectively, had about 50 and 80 per cent of the federal taxes collected in their states returned in federal expenditures.[25] Minas Gerais was alleged to be very highly favored, especially with

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[22]Antoine Renard, *S. Paulo é Isto* (S. Paulo, 1933).

[23]*Ibid.*, pp. 35-36.

[24]*Ibid.*, p. 36.

[25]*Ibid.*

respect to expenditures on railroads. The state of Paraná, with combined tax revenues (federal, state and municipal) of less than 69,000 contos de réis had a negative balance[26] with the national government which was greater than that of Minas Gerais; a state having combined tax revenues four times greater in size.[27]

Except for the states of Pernambuco, Bahia, Pará and Alagôas, the northern region of Brazil generally enjoyed positive balances with the federal government, that is, they received a net inflow of income.[28] Furthermore, the four northern states presenting negative balances transferred resources to the federal government totaling less than 100,000 contos de réis; this amount being only a small fraction of the total national expenditures of 2,186,720 contos de réis.[29] The western states of Goiás and Mato Grosso also received net inflows of federal expenditures.

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[26]That is, the federal government's collection of taxes in Paraná was in excess of its expenditures there.

[27]Renard, *S. Paulo é Isto*, pp. 36-37.

[28]The Northeast was especially well treated in terms of federal expenditures during the tenure of President Epitacio Pessoa (1919-23). Pessoa, a northeasterner, greatly augmented expenditures on anti-drought public works projects on the basis of foreign credit and the earmarking of 2 per cent of federal revenues. Between 1919 and 1923, 378 million milréis (or about $150 million) were spent on public works in the Northeast. See Albert O. Hirschman, *Journeys Toward Progress* (New York: Twentieth Century Fund, 1963), pp. 29-34.

[29]Renard, *S. Paulo é Isto*, p. 37.

Based on the above data, Renard concluded that, excluding the Federal District, the state of São Paulo contributed resources to the federal government equal to the sum of all the other states added together.[30] This conclusion lent credence to the saying in São Paulo that they (the Paulistas) were the "locomotive pulling twenty empty freight cars" (the other states).

In 1937, a comprehensive study of the economy of São Paulo by Alfredo Ellis, Jr. reached a similar conclusion.[31] Using much of the same data as Renard, Ellis tried to show that not only were federal expenditures in São Paulo meager, but that they were channelled through inefficient ministries which actually worked to the detriment of the state. The ministries of agriculture and transportation were among those which received the greates criticism. In the general field of transportation, figures cited by Ellis reveal that São Paulo was particularly slighted in the spending on national railroads. Up to 1922, this state received only 6.5 per cent of these expenditures, while during the same period the states of Minas Gerais, Bahia and Rio Grande do Sul were receiving 25 per cent, 11.9 per cent and 10.9 per cent, respectively, of the total.[32]

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[30] *Ibid.*, pp. 37-38.

[31] Alfredo Ellis, Junior, *A Evolução da Economia Paulista e suas Causas*, Brasiliana, Vol. 90 (São Paulo: Companhia Editora Nacional, 1937).

[32] *Ibid.*, p. 213.

Due to the form in which the statistics were presented, it is impossible to compute the exact magnitude of regional income redistribution through the federal budget, but it does appear that the Paulistas did bear a high federal tax burden in relation to expenditures in their state. Table 10, which shows per capita federal revenues and expenditures in all the Brazilian states in 1928, seems to verify this hypothesis. One must be careful, however, not to take these figures too literally. Although they probably approximate the relative positions of the states, the accuracy of the absolute data can be questioned.

To get a more accurate picture of federal taxation and expenditure in the various states, more would have to be known about the final incidence of the two main federal taxes, that is, import duties and excises. Since both of these are indirect taxes, it is quite doubtful that the sum of all the import duties and excises attributed to one state was actually paid by the people residing in that state. For example, the import duties collected in São Paulo were registered mainly at the customs house of Santos, a port which served the state of São Paulo but also the states of Goiás, Mato Grosso, the southern part of Minas Gerais and the northern part of Paraná. Although the import duties were technically paid by the importers in Santos, it is highly likely that they were included in the

TABLE 10

Regional Distribution of Federal Revenues and Expenditures, 1928[a]

State and Region	Revenues per capita (milréis)[b]	Expenditures per capita (milréis)	Net Inflow (+) or Outflow (-) (contos de réis)
NORTH			-6,327
Amazonas	27.6	28.7	+4,444
Pará	19.2	10.9	-10,771
NORTHEAST			-78,202
Maranhão	9.0	10.9	+2,042
Piauí	4.8	7.8	+2,249
Ceará	15.5	17.7	+3,375
Rio Grande do Norte	10.3	13.3	+2,045
Paraíba	7.5	8.2	+896
Pernambuco	26.8	8.1	-49,714
Alagôas	10.6	6.0	-5,181
Sergipe	11.8	11.0	-451
Bahia	15.9	7.4	-33,463
EAST			+71,211
Espírito Santo	16.6	10.8	-4,329
Rio de Janeiro	20.8	5.8	-28,050
Federal District	621.9	697.8	+114,297
Minas Gerais	8.8	7.3	-10,707
SOUTH			-683,912
São Paulo	120.5	16.3	-610,694
Paraná	32.2	18.7	-12,051
Santa Catarina	19.9	20.9	+863
Rio Grande do Sul	45.9	23.2	-62,030
CENTRAL WEST			+3,952
Mato Grosso	16.4	23.7	+1,605
Goiás	1.7	4.1	+2,347
BRAZIL	61.3	55.8	

Source: Computed by the author on the basis of revenue and expenditure data in Normano, *Economic Types*, pp. 137-38 and population data in Brazil, IBGE, *Anuário Estatístico—1939/40*, pp. 1294-96.

[a]Does not include revenues and expenditures of 41,501 contos de réis and 540,376 contos de réis, respectively, by the London branch of the national treasury.

[b]A milréis was worth about U. S. $.12 in 1928.

price paid by the consumers in São Paulo and in the other states which received merchandise through this port. As a result of the statistical procedure which attributed the sum of all import duties collected in the port of Santos to the state of São Paulo, the burden of these taxes on the people of São Paulo is undoubtedly overstated.[33] For much the same reasoning, the per capita federal revenue figure for the Federal District (the city of Rio de Janeiro) is also overstated. The Federal District was Brazil's major port and hence served the needs of many of the land-locked states in the interior. One inland state, Minas Gerais, probably has its per capita tax burden highly understated since it received virtually all of its imports through Santos and Rio de Janeiro.

A portion of the federal excise taxes collected in individual states was also paid by persons in other regions due to internal trade. São Paulo, for example, exported between 20 and 30 per cent of its industrial production to other states.[34] One must recognize, however, that São Paulo imported large quantities of goods from other states. In fact, data cited by Ellis show that in the years between 1920 and 1930, São Paulo had a sizeable negative balance

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[33]One of the few authors writing at this time to recognize this point was J. Resende Silva. See his *A Fronteira do Sul* (Rio de Janeiro: Imprensa Nacional, 1922), p. 695.

[34]Renard, *S. Paulo é Isto*, pp. 92-93.

in its maritime commerce with the rest of the Brazilian states.[35] Hence, it follows that the amount of federal excise taxes paid by the Paulistas is understated.

If suitable statistics were available, one factor which should have been included in the computation of federal expenditures by state is the amount of spending through the fiscal branch of the national government in London. In 1928, such expenditures reached a total of over 500,000 contos de réis or 26.8 per cent of the national budget in that year.[36] Primarily earmarked for servicing the foreign debt, this expenditure should rightfully be allocated to those states which benefited from the incurring of this debt. If this could be done, the position of those who hypothesize that São Paulo financed the development of the rest of the country would most certainly be enhanced. A glance at a complilation of the federal government's foreign debt during the First Republic reveals that most of the proceeds were used for the construction of railroads in Minas Gerais and Bahia, road and port construction in the Northeast and improvements in the port of Rio de Janeiro.[37] Relatively little seems to have been employed in São Paulo.

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[35]Ellis, *Economia Paulista*, p. 280.

[36]Normano, *Economic Types*, p. 138

[37]*Ibid.*, pp. 162-63.

To summarize, then, statistics do indicate that substantial regional redistribution of income did take place through the fiscal mechanism. Although the peculiarities of statistic collecting process prevent a completely accurate picture of this extent of this redistribution, one could surmise that the general redistribution of regional income was from the Center-South to the North and West, that is, from the wealthiest region to the poorer regions. Among the states of the central-southern region, São Paulo was the largest net contributor. In terms of current federal revenues and expenditures, the state of Minas Gerais was also a net contributor, but to a very small degree. If federal expenditures on servicing the foreign debt could be allocated to the states which benefited from the proceeds of this debt, we might find that Minas Gerais was actually a net recipient of income even though the official statistics understate its per capita federal tax burden.

Distribution of Revenues and Expenditures by Category

Revenues

During the years of the First Republic, the revenue system of the national government and the states predominately

depended upon the foreign sector.[38] Although delegated several sources of revenue not related to international trade (see Table 2, Chapter III), both the federal and state governments retained import and export duties, respectively, as their most lucrative revenue sources. Table 11 clearly documents this contention. It can be noted, however, that this dependence on the foreign sector as a source of revenue seemed to decline over the period in question. This decline was in part a reflection of structural changes in Brazil's internal economy.[39]

An important factor in this respect concerned the effects of World War I on Brazilian public finances. One result of the international conditions produced by this war was the strengthening of existing industrial firms and the encouragement of the growth of new firms in those

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[38]With the expiration of a treaty with England (in 1844) which had limited the ability of the imperial government to impose tariffs, the importance of customs duties as a source or revenue had grown tremendously. Beginning in the latter part of the nineteenth century and continuing into the twentieth century, high tariff rates served not only as a source of public income but as protection to the nascent industrialists. Interesting accounts of the protectionist sentiments during the First Republic may be found in: Stanley J. Stein, *The Brazilian Cotton Manufacture: Textile Enterprise in an Underdeveloped Area, 1850-1950* (Cambridge: Harvard University Press, 1957), chs. 7-8, *passim* and Nícia Vilela Luz, *A Luta pela Industrialização do Brazil* (São Paulo: Difusão Européia do Livro, 1961), chs. 3-5, *passim*.

[39]In this respect, Brazil appears to conform to Hinrichs' generalizations concerning the changes in a nation's tax structure accompanying economic development. See Harley H. Hinrichs, *A General Theory of Tax Structure Change During Economic Development* (Cambridge: Law School of Harvard University, 1966), esp. ch. 6.

TABLE 11

Taxes on the Foreign Sector as a Percentage of Total Federal and State Revenues, Selected Years, 1900-30

	1900	1914-16	1917-19	1923-25	1930
Federal (import duties)	53.6	40.8	30.4	35.0	37.3
State (export duties)	n.a.	46.9	41.5	37.3	32.7

Source: Adapted from Brazil, IBGE, *Anuário Estatístico—1939/40*, 1410-11 and 1416.

product lines whose supply was restricted by the hostilities in Europe.[40] This occurrence obliged the federal government to become more dependent on internal excise taxes as a source of income, since revenues from import duties were falling rapidly.[41] The industrial interests (mainly in São Paulo) made use of this factor in their continuing campaign to obtain aid from the national government in the form of protective tariffs. The industrialists at this time were particularly at odds with the importers, the coffee growers, and the general public, both of whom were clamoring for

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[40]One author concludes that the increases in production during World War I were almost soley the result of more intensive use of the existing productive capacity. The meatpacking industry, which did manage to enlarge its plant size, was a notable exception. See Warren K. Dean "São Paulo's Industrial Elite, 1890-1960" (Ph.D. dissertation, University of Florida, 1964), pp. 80-83.

[41]Luz, *Industrialização do Brasil*, p. 145.

lower tariff rates. The industrialists apparently had the greater political influence, since high tariff rates remained in effect throughout the 1920's.[42]

Other important revenue sources of the national government were the stamp tax and the income from public enterprises such as the federal railroads and shipping line. These two sources comprised 12.2 per cent and 15.4 per cent, respectively, of total federal government revenues in 1930.[43] At the state level, other important revenues were the tax on the transfer of property as well as the income from state enterprises; the former comprising 8.2 per cent of total revenues in 1930 and the latter comprising 21.9 per cent.[44]

It is virtually impossible to generalize about municipal revenues during the First Republic since their nature varied so greatly from state to state and from municipality to municipality. A sample budget (1930) from the municipality of Juiz de Fóra in the state of Minas Gerais reveals the following revenue sources in order of their productivity: tax on buildings (27.9 per cent of the total), tax on industries and professions (19.7 per cent

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[42]Stein, *Brazilian Cotton Manufacture*, pp. 125-28.

[43]Brazil, IBGE, *Anuário Estatístico—1939/40*, p. 1411.

[44]*Ibid.*, p. 1417.

of the total), water fees (12.5 per cent of the total) and a tax on the transfer of property (11.6 per cent of the total).[45] In addition to the four revenues mentioned above, the same budget contains nineteen other separate sources, mostly in the form of fees, licenses or fines. Since no revenue sources were delegated to the municipalities in the 1891 Constitution, such a multiplicity of accounts was commonplace.

Expenditures

An anlysis of the functional distribution of national and state expenditures is difficult, since data were presented according to the amounts expended by the various ministries or secretaries. At the national level, the most important ministries in terms of expenditures were the Ministry of Finance, the Ministry of Transportation and Public Works and the Ministry of War (see Table 12). The expenditures of the Ministry of Finance, however, usually dominated the national budget mainly on account of the large payments made on the foreign debt. In 1928, for example, service of the foreign debt absorbed about 50 per cent of this ministry's expenditures and about 20 per cent of the entire national budget.[46]

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[45]Carvalho, *Revolução de 30*, p. 155.

[46]Brazil, IBGE, *Anuário Estatístico—1939/40*, p. 1411 and Brazil, IBGE, *Anuário Estatístico—1937*, p. 867.

TABLE 12

Distribution of Federal Expenditures by Ministry in Selected Years, 1900-29 (as per cent of total expenditures)

	1900	1910	1920	1929
Finance	55.8	39.5	19.5	38.8
Justice[a]	5.3	7.8	6.1	8.5
Foreign Relations	.6	.9	.8	1.4
Transportation and public works	21.2	27.6	40.2	21.9
Agriculture	. .	3.4	3.5	2.8
War	17.1	20.3	16.7	18.3

Source: Adapted from Brazil, IBGE, *Anuário Estatístico—1939/40*, p. 1412.

[a]Includes expenditures on education.

The states' expenditures were concentrated in the areas of transportation, public works, education, public safety (state militias) and the servicing of the debt (see Table 13). Before 1930, matters pertaining to such crucial areas as education and labor were left almost entirely to the states. Transportation, immigration and commodity price stabilization are examples of fields which had joint federal-state jurisdictions.[47]

At the municipal level, public expenditures were usually directed toward matters of a purely local nature such as streets, lighting, sanitation and administration as well as servicing the debt, both foreign and domestic. Municipal expenditures tended to be as varied as their revenues because of their basically local origin. In the municipalities (and most surely at the state and national levels as well) we also find a certain amount of public funds disappearing into the pockets of local officials. The division between public monies and the personal funds of the particular "colonel" in power was often artificial.

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[47]A discussion of federal-state cooperation (and lack of cooperation) in the areas of transportation and immigration can be found in: Thomas Palmer, "The Locomotive and Twenty Empty Freight Cars," *Inter-American Economic Affairs*, IV, No. 2 (1950), 71-94.

TABLE 13

Functional Distribution of State Expenditures
in Selected Years, 1914-15—1930
(as per cent of total expenditures)

	1914-15	1917-19	1923-25	1930
Administration	5.3	4.7	3.6	6.6
Finance	24.5	24.4	23.5	24.0
Justice	4.8	4.5	3.6	2.8
Law and Order	17.7	17.7	16.0	13.0
Education	14.0	13.9	13.2	14.9
Health	. .	. .	. .	4.3
Transportation and public works	5.5	6.7	8.2	25.0
Other	28.2	26.1	31.9	9.4

Source: Adapted from Brazil, IBGE, *Anuário Estatístico—1939/40*, p. 1418.

The Fiscal Provisions of the 1891 Constitution: Disagreements and Interpretations

As a result of the financial arrangements of the 1891 Constitution, certain sources of friction arose between the federal government and the states as well as between the states themselves. These disagreements were of basically two types: dissatisfaction over the actual constitutional provisions and differences of opinion as to how these provisions should be interpreted.

Insufficiency of Federal Revenue Sources

A disagreement of the first type arose shortly after the declaration of the republic. In the writing of the 1891 Constitution an important consideration was the division of revenue sources between the federal government and the states. The draft originally submitted by the provisional government contained a division of exclusive sources highly favorable to the federal government. According to this document, the states were only allowed to levy a tax on land, a tax on the transfer of property and an export tax which would be abolished after 1898. The national government was delegated the far more lucrative sources of import duties, stamp taxes, taxes on the arrivals and departures of ships and the proceeds from the federal

postal and telegraphic services.[48] After much debate in the assembly, the Commission of Twenty-One (comprised of a representative from each state) added a property tax to the states' exclusive revenues as well as abolishing the time limit on the expiration of the export tax.

The "ultrafederalists," however, sought a division of revenue sources even more beneficial to the states. They suggested that the national government retain the taxes allocated to it in the original draft, but that the stipulation calling for concurrent jurisdiction over nonspecified taxes be dropped. If it had been adopted, this proposal would have given the states power to levy all taxes not specifically charged to the central government. A compromise was reached after further discussion and the final version of the constitution contained the separation of revenue sources discussed in the previous chapter. The federalists seemed to have dominated in the writing of the final draft; João Torres calls the fiscal provisions of the 1891 constitution a triumph of "statism."[49]

The public finance statistics of the early federal period appear to authenticate Torres' judgement. The state of São Paulo, for instance, collected more revenue during

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[48]João Camillo de Oliveira Torres, *A Formação de Federalismo no Brasil*, Brasiliana, Vol. 308 (São Paulo: Companhia Editora Nacional, 1961), p. 173.

[49]*Ibid.*, p. 178

the first four years of the republic than it had during the sixty-seven years of the empire.[50] Additional evidence shows that Minas Gerais' first state budget exhibited revenues over two and one-half times larger than those in its last provincial budget.[51] National government revenues, on the other hand, had increased only moderately as compared to the latter years of the empire.

This initial situation worsened at the beginning of the twentieth century as the states began to complain of federal invasion of the states' rights of taxation. One such dispute was over the interpretation of Section 1, Article 9 of the 1891 constitution. This passage outlined the jurisdiction of the states to collect stamp taxes "on documents issued by their respective governments and on affairs of their own economy." The phrase "affairs of their own economy," being imprecise, resulted in the passage of federal law 585 of July 31, 1899, which "defined the relative jurisdictions of state and nation in the field of stamp taxes by declaring that these transactions of the economy of the states were only such as are governed by state laws."[52] This interpretation of the constitutional

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[50]Palmer, "Freight Cars," p. 56.

[51]Torres, *Formação de Federalismo*, pp. 208-09.

[52]James, *Constitutional System of Brazil*, p. 41.

provision was thought to have severely narrowed the tax base of the states in the area of stamp taxes. At the time, São Paulo self-righteously pointed out that only it, among the states, had not invaded *federal* rights of stamp taxation. This was done, claimed the Paulistas, at a yearly loss of 600 contos de réis to the São Paulo state treasury.[53]

The charges of federal invasion into the states' sphere of taxation continued throughout much of the First Republic. In 1916, Altino Arantes, the governor of São Paulo, accused the national government of levying several taxes which he claimed were both unconstitutional and detrimental to the states. Included among these were a consumption tax on industrial products, a stamp tax on the transfer of property and taxes on the dividends of firms operating within one state.[54]

Interstate Taxes

Another problem arose at this time concerning jurisdiction over the taxation of interstate commerce. Two main questions were involved: (1) Could the states interpret their right to levy export taxes as being applicable to exports going to other states? (2) Could the

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[53]Palmer, "Freight Cars," p. 57.

[54]*Ibid.*, p. 59.

states levy import duties on goods coming directly into their territory from other states? The first question was not a great problem to the Paulistas since this state enjoyed large receipts from taxing its exports to foreign countries. It was only a vital question to those states which did not export very much abroad. Although numerically large, this latter group of states was generally poor and politically weak. Supreme court decisions pertaining to the rights of states to tax their exports to other states were continually conflicting during the years of the First Republic. The court reversed its opinion on this matter no less than four times between 1896 and 1918.[55] A later constitutional provision ended the problem by holding that state export taxes were only applicable to goods shipped to foreign destinations.

The question of taxes on imports of merchandise from other states did result in much resentment in the state of São Paulo. In the early years of the federation, all states (except São Paulo, Santa Catarina and Rio de Janeiro) were imposing taxes on goods entering their respective territories. The confusion over the question of interstate taxation had its source in the constitutional provision which reserved the power to levy duties upon

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[55]James, *Constitutional System of Brazil*, p. 40.

goods of "*foreign origin*" to the federal government.[56] Since the states were free to impose any tax not specifically given to the federal government nor forbidden to them, many took the view that taxing imports from other states was constitutional.

Before 1904, decisions of the Brazilian supreme court were contradictory on this subject.[57] State deputies from São Paulo tried to have these taxes declared illegal, but admitted that the constitution was unclear on this point. These deputies based their argument on the fact that the state of São Paulo was being discriminated against, that is, products of other states were entering its territory untaxed while the products of São Paulo were being taxed upon passing across the borders of other states.[58]

The supreme court continued to hand down decisions calling for the abolition of this type of interstate taxation and a national decree was issued to this end. This decree was apparently ignored by the states, since these taxes represented a very lucrative source of income. Although theoretically abolished in 1931, it was not until a constitutional prohibition was rigorously enforced in 1934 that these interstate import duties disappeared.[59]

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[56]Brazil, *Constitution* (1891), Art. 7, No. 1.

[57]Palmer, "Freight Cars," p. 58.

[58]*Ibid.*

[59]*Ibid.*, p. 59.

State and Municipal Indebtedness

Before 1930, another issue which continued to cause concern at the national level was the growing foreign debt of the states and municipalities. The 1891 constitution had not prohibited these entities from incurring foreign debt without prior federal approval. Table 14 gives an indication of the magnitude of this debt. The absolute growth of these figures is greatly overstated due to the depreciation of the Brazilian monetary unit during the 1912-32 period but, nevertheless, the amounts in dollar terms were quite sizeable by 1932. In that year the foreign debt balances of the federal, state and municipal governments reached approximately $566 million, $388 million, and $110 million respectively.[60]

Perhaps the most significant aspect of the data in Table 14 is that the foreign debt outstanding of the states (and to a lesser extent the municipalities) grew substantially in relation to the federal foreign debt during the 1920's. The foreign debt of the states increased from about 25 per cent of the federal debt in 1922 to about 60 per cent a decade later. The foreign debt balances of the municipalities, on the other hand, grew from about 17.5 per cent of the federal debt in 1928 to 19.5 per cent in 1932.

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[60]Converted at the "pegged" rate of 1 conto de réis = U. S. $74.

TABLE 14

Federal, State and Municipal Foreign Debt Balances Outstanding, Selected Years, 1912-32 (in thousands of contos de réis)

Years (Dec. 31st)	Federal	State	Municipal	Total
1912	1,391	609	n.a.	. . .
1922	4,850	1,193	n.a.	. . .
1928	6,045	2,665	1,056	9,766
1932	7,650	4,572	1,492	13,714

Source: Adapted from Brazil, IBGE, *Anuário Estatístico—1937*, p. 867 and Brazil, IBGE, *Anuário Estatístico—1939/40*, pp. 1424-25.

An important causal factor in the growth of state and municipal foreign debt was the autonomy given to these entities in the 1891 Constitution. This freedom prompted the lower levels of government (primarily the states) to enter into large-scale public works projects like docks and railroads, and in the state of São Paulo, coffee price stabilization.[61] Since adequate financing for these expenditures was commonly not available through domestic sources, recourse was often made to foreign credit.[62]

As the size of this state and municipal indebtedness enlarged, defaults and violations of contractual agreements with the foreign creditors became frequent.[63] By 1928, service of the foreign debt was absorbing about 17 per cent of total state expenditures and about 10 per cent of total municipal expenditures.[64] Since several states and many

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[61]For data in the financing of the coffee price stabilization program see Moore, "Brazilian Coffee Economy," pp. 215-26.

[62]An indication of the paucity of internal state funds in relation to expenditure needs is illustrated by the fact that the state of São Paulo balanced its budget only once between 1905 and 1930 (in 1920).

In 1930, São Paulo was also the largest holder of foreign debt among the states; accounting for approximately 75 per cent of the total state debt in British pounds (including the debt of the Bank of the State of São Paulo and the Paulista Coffee Institute) and approximately 50 per cent of the state debt in American dollars. Brazil, IBGE, *Anuário Estatístico—1939/40*, pp. 1424-25.

[63]James, *Constitutional System of Brazil*, p. 42.

[64]Brazil, IBGE, *Anuário Estatístico—1939/40*, p. 1409.

municipalities had small or nonexistent foreign debts, the fiscal burden on those having the large debts was very great.[65]

The national government, fearing possible international consequences and damage to its own credit rating, tried to take steps to control state and municipal borrowing abroad. To this end, a bill was introduced in the national senate of 1912 which would have obliged these entities to obtain federal approval before contracting foreign loans.[66] Although this bill was defeated, discussion of this matter continued throughout the 1920's. The fact that such a law was not passed during the First Republic is another indication of the power of the states vis-à-vis the federal government. It was not until the Vargas era in the 1930's that the widespread foreign borrowing of the states and municipalities was proscribed by the federal government.

Summary

The federal system prevailing in Brazil between 1889 and 1930 was a reflection of the social, political and

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[65]A compilation of the loans contracted by the states and municipalities and the payment schedules imposed upon them by the foreign bankers can be found in: Gustavo Barroso, *Brasil—Colonia de Banqueiros (Historia dos empréstimos de 1824 a 1934)* (3rd ed.; Rio de Janeiro: Civilizãçao Brasileira, S/A., 1935), pp. 139-75.

[66]James, *Constitutional System of Brazil*, p. 42.

economic realities of the era. It represented a complex set of balances between the interests of the national government, the states, the "coronéis," the coffee growers, the industrialists and other groups. Although open conflict sometimes marred these relationships, the severity of these clashes was never sufficient to destroy the system.

The most important intergovernmental relationship of the period was between the federal government and the states. A source of conflict arose between these entities as a result of the constitutional division of revenue sources. Although this division had originally been obtained through a process of compromise, it soon became clear that the states had been allocated the most productive sources. Disagreements were voiced as the federal government tried to invade the exclusive taxing spheres of the states, but this conflict did not result in a breakdown of the federation. The solution seems to have been for the federal government to turn to the printing of money and/or borrowing abroad to meet its expenditure needs. The states, also confronted with a growing demand for public services, resorted to foreign borrowing themselves.

A potential source of fiscal conflict also arose between the states and municipalities. The municipalities, having no separate rights of taxation, were in many cases, financially dependent upon the states. This was especially

true in the rural areas where a sufficient tax base was almost totally lacking. This absence of financial resources usually prevented anything more than a minimum level of municipal services. Since remaining securely in local political office, however, often demanded the showing of at least some "public spirit" such as the building of a road, school or soccer field, it was tempting for the municipal governments to invade the tax jurisdictions of the states without permission. Although this no doubt occurred on some occasions, the usual solution was for the incumbent "colonel" to receive funds from the state in return for political favors.[67] Through this mechanism, one possible source of friction in this fundamental relationship of the First Republic was alleviated.

Perhaps the dominant fiscal characteristic of the young federation was a direct result of the extreme inequality of wealth among regions, that is, the underdevelopment of public services in the northern and western states. Although the first republican constitution granted considerable autonomy to the states, this freedom was meaningless to those states which had low levels of economic development and small tax bases. Statistics show that as a result of this, only the public sectors

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[67]Leal, *Coronelismo*, p. 27.

of the richer states were able to develop a very high level. Although this problem was never resolved, it was somewhat alleviated by income transfers from the richer states to the poorer states through the federal budget. This partial solution to the problem, however, created antipathy between the state of São Paulo and the federal government which continues to the present day.

A final important relationship which existed during the First Republic was between the coffee growers and the industrial interests. Often at odds with each other, both groups managed to obtain concessions from the government. A primary point of contention was the tariff question. As was mentioned earlier in the present chapter, the industrialists were protariff and the coffee growers were generally antitariff. Although the protariff forces finally prevailed, the coffee interests were placated in other ways. Both the states (mainly São Paulo) and the federal government entered into agreements to encourage the immigration of agricultural workers and also set up the apparatus for supporting coffee prices. These price stabilization programs, although primarily intended to help the coffee growers, also benefited the industrialists since they included provisions for artifically lowering the dollar-milréis exchange rate. This undervaluing of the milréis served the purposes of both groups because the

planters increased their earnings in domestic currency and the industrialists benefited from the increased internal price for imports.[68]

As a result of such balances and compromises among the component parts of the Brazilian federation, an acceptable degree of harmony existed for four decades. By 1930, however, the collapse of the system was imminent. Due to social, political and economic changes which started accelerating in the 1920's, the potential conflicts which had always existed became intolerable to the interests involved.

The following chapter seeks to analyze this breakdown and the new system with which it was replaced. Brazilian federalism took on new characteristics in almost every respect after 1930, the fiscal area being no exception.

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[68]Luz, *Industrialização do Brasil*, pp. 142-43.

CHAPTER V

BRAZILIAN FISCAL FEDERALISM IN PRACTICE (2): THE REVOLUTION OF 1930 AND THE CONSTITUTION OF 1934

The years between 1930 and 1945 represented an extremely important period of Brazilian history. During this decade and a half, the nation began to shed its traditional past. In this transformation, the public sector played a vital role. The "dualist federalism" of the First Republic, dominated by the oligarchies of a few important states, was replaced by a strong national government intent on affecting almost every segment of Brazilian life.

It is the purpose of the present and the following chapter to analyze this basic change in the role of the State from the standpoint of the public finances. Before beginning this analysis, however, it is useful to briefly outline the circumstances surrounding the collapse of the First Republic.

The Collapse of the First Republic

The First Republic, which lasted four decades, was held together by a delicate balance between various political, economic and social interests. The federal government

shared power with the states; the dominant states of São Paulo, Minas Gerais and Rio Grande do Sul shared power with each other; the local "colonels" compromised with the state and national governments; and the traditional agriculturists began sharing power with the new urban industrialists. Although a type of federalism did emanate from these sets of balances, its existence depended upon continued harmony among the component parts.

As early as the 1920's, however, there were indications that the system of the First Republic was beginning to crumble. Internal revolts in 1922 and 1924, by young army officers eager for change, revealed a weakening of the old system. The world depression, the outcome of the 1930 presidential elections and the assassination of a northeastern politician were the sparks which finally ignited the situation.

Armed revolution broke out in October, 1930, and in less than a month of fighting, the dissident forces succeeded in deposing incumbent president Washington Luíz and installing Governor Getúlio Vargas of Rio Grande do Sul as leader of the country. This event marked the end of the First Republic and the beginning of fifteen years of almost uninterrupted dictatorship.[1]

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[1]For a more detailed account of this period see Thomas E. Skidmore, *Politics in Brazil, 1930-1964: An Experiment in Democracy* (New York: Oxford University Press, 1967), pp. 3-12.

The Public Sector Under Vargas: An Overview

The Brazilian public sector underwent a significant transformation in the 1930-45 period. Not only did government in general assume new responsibilities, but the fundamental federal relationships of the First Republic were irrevocably altered. More specifically, the "dualist federalism" of the 1891 Constitution was replaced by a centralized system which came to be federal in name only. In contrast to the laissez-faire liberalism which characterized the early years of the federal republic, the Vargas era witnessed the rise of a paternalistic state concerned with the plight of Brazil's "forgotten man."

Within this basic structural transformation of the public sector, the federal government played the dominant role. Greatly extending its authority and influence in such areas as labor, education, social welfare and national and regional economic development, the national government successfully usurped much of the functional responsibilities and political autonomy previously exercised by the states and municipalities. This process of centralization took many forms, although it proceeded rather steadily throughout the 1930 to 1945 period, with some acceleration of the trend to be noted after 1937.

The extent to which the public sector was modified during the Vargas era, however, is not readily perceived

by a simple analysis of the budgetary expenditures of the federal, state and municipal governments. The combined expenditures of these three administrative units, although experiencing almost a fivefold growth in current terms, probably did not grow significantly in relation to the national product.[2] In addition, the relative financial importance of the federal government as expressed by this unit's budgetary expenditures as a percentage of total budgetary expenditures seems to have changed little during the Vargas era.[3] As presented in Table 15, federal expenditures, while varying between 49.2 per cent and 59.5 per cent of the total, exhibited no clear tendency to centralize over the period.[4]

An accurate understanding of the changes in the Brizilian public sector which came about during the 1930-45

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[2]Although reliable national accounts are virtually nonexistent before 1947, some estimates of the NNP for 1929-45 may be found in Carlos Manuel Pelaez, "Acerca da Política Governmental da Grande Depressão e da Industrialização no Brasil, *Revista Brasileira de Economia*, XXIII, No. 3 (1969), 84.

[3]A statement of the conventional wisdom that the percentage of total expenditures accounted for by a particular level of government reflects its "power" is found in Frank P. Sherwood, *Institutionalizing the Grass Roots in Brazil: A Study in Comparative Local Government* (San Francisco: Chandler Publishing Co., 1967), p. 11.

[4]The state-local relationship, however, did change and will be discussed later in the present chapter.

TABLE 15

Federal Expenditures as a Percentage of Total Budgetary Expenditures,[a] 1930-45

Year	% of Total Exp.	Year	% of Total Exp.
1930	54.1	1938	59.5
1931	49.2	1939	56.7
1932	59.0	1940	56.7
1933	55.5	1941	56.0
1934	57.5	1942	56.8
1935	53.9	1943	54.3
1936	54.0	1944	55.2
1937	57.9	1945	55.6

Source: Adapted from Brazil, IBGE, *Anuário Estatístico—1949*, p. 545.

[a]The combined expenditures of the federal government, states, municipalities and the federal district.

period, obviously requires more than a simple analysis of budgetary expenditures. To this end, much of the present chapter will be devoted to a discussion of those tendencies to be noted during the Vargas era which are not adequately reflected in this data. Among the most important of these are:

1. Intergovernmental transfers of functional responsibility (mainly from state to federal jurisdiction).

2. The growth of extra-budgetary revenues and expenditures (mainly channelled through federally controlled semiautonomous institutes and semipublic enterprises).

3. Declining political and financial autonomy at the state and municipal levels.

4. Growing bureaucracy and political patronage at the federal level.

5. Growing federal control over organized labor and other segments of the private sector.

Although each of these five methods was utilized by the federal government to promote political and financial centralization, their relative importance varied during the fifteen years of Vargas' rule. To analyze them properly thus requires an examination of the public sector from the standpoint of meaningful subperiods. For present purposes, the 1930-45 period will be divided into three such subperiods: (1) The Provisional Government, 1930-34, (2) The return to constitutional democracy, 1934-37, and (3) The Estado Nôvo, 1937-45. The first two will be discussed below while the third will be the subject of the chapter which follows.

The Provisional Government, 1930-34

Upon assuming the office of Provisional President in November, 1930, Getúlio Vargas was immediately faced with severe political, economic and social problems. As described by Oswaldo Aranha, Vargas' first Minister of Justice and Internal Affairs:

> The country was without money, without exchange, actually and legally in a moratorium with pressing promises to be met abroad, due or to become due in a few days; a floating debt, federal, state and local which had never been calculated; coffee in three crises—price, overproduction, and large stocks in warehouses; the Brazilian economy, industry, and labor in ruin; and an unemployment crisis.[5]

In order to alleviate these problems, the Provisional Government rapidly enacted a comprehensive body of decree laws. Spanning a wide spectrum of topics, the directives of the Provisional Government undoubtedly inaugurated the centralization which was to characterize the Vargas era.

Political Directives

One of the first efforts of the new regime was to issue Decree 19,398. As described in Chapter III, this Decree provided for virtually complete federal control over the country. Federalism, by almost any definition,

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[5]Cited by Harvey Walker, "The Vargas Regime," in *Brazil*, ed. by Lawrence H. Hill (Berkeley: University of California Press, 1947), p. 109.

ceased to exist. Although lip service was paid to the financial autonomy of the states, it was meaningless when accompanied by the total absence of political autonomy at that level of government. By allowing freedom of action at the federal level, this Decree paved the way for substantial legislation in the economic, financial and social areas.

Economic and Financial Directives

As indicated by the quote from Oswaldo Aranha, one of the most pressing problems of the Provisional Government was coping with the economic and financial chaos brought about by the Great Depression. The following statistics illustrate this point.

The price per pound of coffee (Santos 4) had fallen from U. S. $.2450 in March, 1929, to U. S. $.1025 in December, 1930, and the Brazilian gold reserves had disappeared through efforts to support the rate of exchange.[6]

Upon the failure of this support, the external value of the milréis plummeted by almost one-third between 1930 and 1931, falling from U. S. $.108 in the former year to U. S. $.073 in the latter.[7] Furthermore, deteriorating

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[6]Brazil, DNC (Departamento Nacional do Café), *Anuário Estatístico do Café—1939/40* (Rio de Janeiro, 1949), p. 170.

[7]Baer, *Industrialization*, p. 271.

economic conditions had caused an abrupt decline in federal, state and municipal revenues, necessitating budgetary deficits in 1930 which equaled over 40 per cent of the total public revenues in that year.[8] As might be surmised from the above data, extreme difficulties were also encountered in meeting the obligations of the country's foreign-owned debt which by 1930 had reached the sum of 6.2 million contos de réis (approximately U. S. $670 million).[9]

In the face of these calamitous economic and financial conditions, the Provisional Government immediately initiated remedial policies. The nature of this legislation involved commodity price and production controls, exchange controls and budgetary reorganization.

Commodity Controls

Coffee

Probably the most important problem facing the Provisional Government was the situation in the coffee sector. Comprising 70 per cent of Brazil's total exports at the time, the vital coffee economy was plagued by over-production coupled with falling prices. As noted above, the price per pound of coffee had fallen by more than half

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[8]Brazil, IBGE, *Anuário Estatístico—1939/40*, p. 1409.

[9]Of this total, 55.7 per cent was federal, 34.2 per cent was state and 10.1 per cent was municipal. *Ibid.*, p. 1422.

between 1929 and 1930 and bumper crops in 1927-28 and 1929-30 had caused an excess of production over exports of 25 million bags for the 1928-30 period.[10] Although falling prices had stimulated the quantity of coffee exported (to a record 17.9 million bags in 1931), the value of these exports declined from 2.7 contos de réis in 1929 to 1.8 contos de réis in 1930.[11] Since coffee had been the country's primary exchange earner, this decline in the product's export value must be considered as a decisive contributory factor in the exchange crisis mentioned above.

As was discussed in the previous chapter, the support of coffee during the First Republic had been carried on mainly by the states, principally São Paulo. With the onset of the Depression, however, falling prices had rapidly drained the resources of the São Paulo Coffee Institute and market support had to be withdrawn. The Institute arranged a £20 million loan (the Coffee Realization Loan) in April, 1930, but worsening market conditions seemingly called for a massive intervention by the federal government.[12]

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[10]V. D. Wickizer, *The World Coffee Economy, with Special Reference to Control Schemes* (Stanford, Cal.: Stanford University Press, 1943), p. 148.

[11]Baer, *Industrialization*, p. 276.

[12]Wickizer, *Control Schemes*, p. 146-47.

This intervention came, however, only after the conclusion of the 1930 Revolution. Vargas' forces, in fact, were supported by a majority of the coffee planters who felt that the Washington Luíz administration had ignored their plight by maintaining a fixed exchange rate while coffee prices were falling, by failing to supply further credit to the São Paulo Coffee Institute and by refusing to stem the rising tide of foreclosures in the coffee areas.[13]

Getúlio Vargas acted quickly to alleviate the crisis. In January, 1931, the federal Interventor in São Paulo reorganized the Coffee Institute of that state and in the following month Vargas ordered the federal finance minister to purchase all coffee stocks in São Paulo existing on June 30, 1931.[14] Financing of this purchase was to be on the basis of credit from the central bank (*Banco do Brasil*), a loan from an American firm on consignment coffee and a barter of 1.3 million bags of coffee for 25 million bushels of wheat from the United States Grain Stabilization Corporation.[15] Other measures taken at this time included a tax in gold on coffee exports, controls on the amount of coffee

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[13]Skidmore, *Politics in Brazil*, pp. 11-12.

[14]Affonso E. de Taunay, *Pequena História do Café no Brasil* (Rio de Janeiro: Departamento Nacional do Café, 1945), p. 432.

[15]Wickizer, *Control Schemes*, p. 149.

arriving at the ports, a tax on new coffee plantings and provisions for the destruction of surplus production.[16]

A federally controlled coffee institute (*Conselho Nacional do Café* or CNC) was created in 1931, and between that year and the beginning of 1933, the federal government and an autonomous institute of coffee producing states (*Conselho dos Estados Cafeeiros*) dictated national coffee policy. To this end, an export tax of 10 shillings per bag of coffee (later changed to 15 shillings and then fixed at 55 milréis) was instituted for the purchase and destruction of surplus production as well as for the servicing of the 1930 Coffee Realization Loan.[17] As a result, over 12 million bags of coffee were burned between 1931 and 1932.[18]

On February 11, 1933, Getúlio Vargas ordered the creation of the National Coffee Department (*Departamento Nacional do Café* or DNC) and at the same time dissolved the CNC. This new Department, although subordinate to the Finance Ministry, was to have administrative and financial autonomy and national jurisdiction.[19] Through this

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[16]Taunay, *História do Café*, pp. 432-33.

[17]Almir de Andrade, *Contribuição a História Administrativa do Brasil na República, Até o Ano de 1945*, 2 vols. (Rio de Janeiro: Livraria José Olympio Editôra, 1950), I, 78.

[18]*Ibid.*

[19]Taunay, *História do Café*, pp. 443-44.

administrative entity the federal government was able to wrest virtually complete control of coffee policy from the states and as such represented a major step in the diminution of state powers.[20] Federal control over coffee policy also allowed the supervision of a sizeable amount of income not reflected in the national budget. Between February 17, 1933, and December 31, 1934, the DNC purchased almost 22 million bags of coffee with an expenditure of over 1 million contos de réis.[21]

In a decision related to the coffee support program, the Provisional Government issued a decree calling for a 50 per cent reduction in the debts of agricultural producers contracted before June 30, 1933.[22] To satisfy the creditors, the federal government issued 500,000 bonds of 1 conto de réis at an interest rate of 6 per cent. This decree of the federal government, known as the *Reajustamento Econômico*, acted to support the income of the coffee sector and, coupled with the coffee purchase program, created an incentive for the increased domestic production of goods

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[20] *Ibid.*, p. 444. The states were theoretically represented in the DNC through a consultative council, but this latter body could only be assembled when ordered to do so by the federally controlled DNC.

[21] *Ibid.*, p. 475.

[22] *Ibid.*, pp. 449-50.

made relatively expensive by the decline in the external value of the milréis.[23]

Sugar

Although coffee was the most important commodity to be jeopardized by adverse market conditions, it was not the only product to be so affected. Sugar, once Brazil's leading product, was also hard hit. The sugar industry had been in decline since the beginning of the republic (see Chapter IV), but the decade of the 1920's was especially unfavorable and was characterized by overproduction, price oscillations and a secular price decline.[24]

The sugar producers and refiners in the state of Pernambuco organized the Sugar Defense Institute (*Instituto de Defesa do Açúcar*) in 1926 for the purpose of controlling production and maintaining prices, but the need for cooperation from producers in other states limited its effectiveness. A conference of representatives of the sugar industry from all the producing states took place in 1928, but it too met with little success. Lack of cooperation among the producers resulted in some of them accelerating

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[23]Primarily as a consequence of this mechanism, national production reached pre-Depression levels by 1934. See Furtado, *Economic Growth of Brazil*, pp. 221-22 and Baer, *Industrialization*, pp. 22-26.

[24]Brazil, IAA (Instituto do Açúcar e do Álcool), *Anuário Açúcareiro--1941* (Rio de Janeiro, 1941), p. 39.

production through newly mechanized facilities.[25] As a result, the total output of sugar jumped by about 25 per cent between the 1928-29 and 1929-30 crops.[26]

This increased production, accompanied by the general downturn of economic conditions, precipitated a rapid and steep decline in prices. The price per bag of sugar, which stood at 76.5 milréis in March, 1929, fell to 22 milréis by September, 1931.[27] The latter price was the lowest ever recorded for Brazilian sugar. In this dismal atmosphere, recourse was made to the federal government.

The Provisional Government did come to the aid of the sugar industry in September, 1931, by calling for the warehousing of 10 per cent of the output of the overproducing states and by instituting a tax on the production of the other states. Although this federal intervention marked the initial stages of a national sugar policy, it was only a stopgap measure. In December of the same year, the federal government created the Commission for the Defense of Sugar Production (*Comissão de Defesa da Produção do Açúcar* or CDPA). This new Commission was to be financed by a

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[25] *Ibid.*, pp. 9-10.

[26] *Ibid.*, p. 39.

[27] Andrade, *História Administrativa*, I, 89.

3 milréis tax per bag of refined sugar. Credit assistance was provided to the producers and steps were taken to curb production. The efforts of the CDPA were apparently successful as the price of sugar rose to a high of 47.5 milréis per bag in 1933.[28]

Encouraged by the effectiveness of its first attempts at stabilizing the sugar industry, the federal government created the semiautonomous Sugar and Alcohol Institute (*Instituto do Açúcar e do Álcool* or IAA) in 1933. This Institute, equipped with powerful regulatory controls and generous financing, became a permanent fixture of the Brazilian public sector. Besides regulating the production and price of sugar, the IAA promoted the production of alcohol from surplus sugar and even constructed several distillaries. Much of the alcohol produced in this manner was mixed with gasoline and utilized as fuel.[29]

The sugar industry, like coffee, thus came under the control of the federal government as the states once again transferred responsibility to the center by default. Although the sugar institutes (the CDPA and IAA) did not represent nearly as large a fiscal entity as did the

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[28]Brazil, IAA, *Anuário Açucareiro—1941*, pp. 13-15.

[29]For historical background on the Brazilian alcohol industry see Andrade, *História Administrativa*, I, 94-111 and Brazil, IAA, *Anuário Açucareiro—1941*, pp. 63-95.

analagous coffee institutes (the CNC and DNC), they did provide assistance to producers (in the form of commodity purchases and loans) totaling almost 100 thousand contos de réis between the 1931-32 and 1933-34 crop years. The revenues of the sugar institutes during this same period reached almost 60 thousand contos de réis.[30]

Exchange Policy

Besides supporting the incomes of the sugar and coffee sectors, the Provisional Government took actions aimed at remedying the exchange and budgetary crises brought about by the worldwide depression. Concerning the former problem, Vargas decreed that all exchange transactions were to be brought under the control of the Bank of Brazil in September, 1931.[31] From that date until 1934, most transactions were made at the official rate of exchange although priorities for obtaining exchange were allowed for government purchases, debt servicing and essential imports.[32]

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[30]Brazil, IAA, *Anuário Acucareiro—1941*, pp. 39-41

[31]Frederic W. Ganzert, "Industry, Commerce, and Finance," in *Brazil*, ed. by Lawrence H. Hill (Berkeley: University of California Press, 1947), p. 293.

[32]Joint Brazil-United States Economic Development Commission, Report of the Commission, *The Development of Brazil* (Washington, D. C.: Government Printing Office, 1954), p. 296.

Accompanying these controls were higher tariffs, especially on agricultural products.

In addition, attempts were made to adjust payments on the foreign-held public debt. Due to the exchange shortage, however, the federal government was forced to declare a moratorium on its debts as well as those of the states and municipalities. Hence, during 1932 and 1933 no payments were made to foreign creditors of the federal government except for those on the funding loans of 1898 and 1914, the coffee security bonds of 1922 and the newly negotiated funding loans of 1931.[33] A special committee was formed to study the finances of the states and the municipalities, but financial difficulties at these administrative levels necessitated defaults on the debt services of most of them during 1932 and 1933.[34]

Social Directives

In spite of the decline of revenues at the federal level, there were great pressures calling for the creation of new national services, especially in the social areas. As a result, two new ministries were organized in 1930: the Ministry of Labor, Industry and Commerce and the

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[33]Ganzert, "Industry, Commerce, and Finance," p. 293.

[34]Brazil, IBGE, *Anuário Estatístico—1939/40*, pp. 1426-27.

Ministry of Education and Public Health. Since responsibility in the fields of labor and education had been left almost entirely to the states during the First Republic, the creation of these two ministries certainly marked an increase in federal power at the expense of the states.[35]

Labor and Social Welfare

Federal activity in the area of labor during the 1930-34 period was primarily concerned with legislating on labor conditions and creating a comprehensive social security system. In line with the policy of undermining the power of the rural oligarchies, practically all of the legislation was for the benefit of the urban worker. To this end, decrees of the Provisional Government provided for the legal recognition of trade unions (*sindicatos*), professional identification cards, protection of national labor from foreign competition and the regulation of working hours.[36]

Of foremost importance to the problem of fiscal federalism, however, was the growth of federally controlled semiautonomous social security institutes and funds

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[35]Skidmore, *Politics in Brazil*, p. 33.

[36]Brazil, Ministry of Foreign Affairs, *Brazil, 1940/41: An Economic, Social and Geographic Survey* (Rio de Janeiro, 1941), pp. 69-72.

(*Institutos e Caixas de Aposentadoria e Pensões*). Through these institutes and funds, the federal government gained control over still another substantial entity not included in national budgetary revenues and expenditures.

The Brazilian social security system did not begin with the 1930 Revolution, but prior attempts had been limited to schemes covering only port and railroad workers. Financed through employer and employee contributions as well as special taxes, these early funds were primarily aimed at providing retirement pensions, although cash awards for invalidity and death and medical care were also provided.[37] The real expansion of the system, however, came about only after the passage of a federal act in 1931.

This new act established a number of funds for particular occupational groups and regions and gave more stress to retirement benefits. As a result, the quantity of social security funds increased from 47 in 1930 to 140 in 1932.[38] Demands from other groups of workers, however, prompted the federal government to authorize the creation of social security institutes with national jurisdictions. In 1933, the first of the national institutes was founded

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[37]Moacyr V. Cardoso de Oliveira, "Social Security in Brazil," *International Labour Review*, LXXXIV, No. 5 (1961), 376-77.

[38]Brazil, IBGE, *Anuario Estatístico—1948*, p. 381.

for the benefit of Brazil's maritime workers (*marítimos*). Three more of these national institutes were established in the following year to cover commercial workers (*comerciários*), stevedores (*estivadores*) and bank employees (*bancários*).[39] By the end of 1934, over 300 thousand persons were directly associated or benefiting from the social security system which by then was comprised of 176 funds and institutes.[40]

Although the most rapid growth of the social security system (in terms of both membership and finances) was to come after 1934, the funds and institutes were able to collect almost 450 thousand contos de réis in the 1930-34 period. This figure represented about 4.5 per cent of total federal budgetary revenues in the same period.[41] Expenditures of the funds and institutes during the first five years of the Vargas regime amounted to about 250 thousand contos de réis, with the surplus being primarily utilized for the purchase of government securities, short-term loans to members and the financing of workers' restaurants and housing.[42]

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[39]Brazil, Ministry of Foreign Affairs, *Brazil, 1940/41*, p. 72.

[40]Brazil, IBGE, *Anuário Estatístico—1948*, p. 381.

[41]Brazil, IBGE, *Anuário Estatístico—1939/40*, p. 1409 and Brazil, IBGE, *Anuário Estatístico—1948*, p. 381.

[42]Ministry of Foreign Affairs, *Brazil, 1940/41*, p. 73.

Education

The profound political, economic and social changes which culminated in the 1930 Revolution also had a great effect on Brazil's educational system. During the First Republic, education was a matter which had been largely in the hands of the states, although the Constitution of 1891 had provided for concurrent authority in the areas of secondary and higher education.[43] As a consequence, education during the period preceding 1930 had developed according to local and regional circumstances with little or no national policy evident.[44] Some reforms of the system were attempted before 1930, but they were, for the most part, state-initiated and ineffectual.

With the creation of the Ministry of Education and Public Health in 1930, the federal government committed itself to a reform of the educational system along national lines. Higher and secondary education received almost

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[43]Indicative of the attitude toward education in the early years of the republic is the following quote from a Minister of the Interior: "however precious may be the advantages of public instruction it is certain that this is absolutely not a matter of direct interest for the nation and therefore not a national concern and is outside the scope of action of the federal government." João Barbalho, *Constituição Federal. Commentários.* (Rio de Janeiro, 1902), pp. 135-36, quoted in James, *Constitutional System of Brazil*, p. 30.

[44]Fernando de Azevedo, *Brazilian Culture*, trans. by William Rex Crawford (New York: Macmillan Company, 1950), pp. 435-36.

immediate attention from the Provisional Government through the issuance of Decrees 19,851 and 19,890 in April, 1931: The former outlined the prerequisites of a national university system while the latter set forth guidelines for secondary education.[45] Primary education also received some attention as the federal government promoted an "Interstate Convention of Educational Statistics" in 1931.[46] Additional conferences arranged by the federal government brought together leading educators from throughout Brazil for the purpose of formulating a comprehensive educational policy to be included in the country's new constitution.

The Brazilian Public Sector, 1934

By the end of 1934, the Brazilian public sector had been considerably altered as compared to 1930. The national government had, in the span of four years, decisively entered the areas of commodity support, exchange control, labor and education. In addition, almost every semblance of state and local political autonomy had been abrogated.

As shown by Table 16, the growing financial impact of the national government (hereafter called the "Union") came about mainly through the creation of the semiautonomous

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[45] *Ibid.*, pp. 451-52.

[46] Brazil, Ministry of Foreign Affairs, *Brazil, 1940/41*, p. 60.

TABLE 16

Expenditures of the Public Sector, 1930 and 1933-34
(in current contos de réis)

	1930		1933-34[a]	
	(millions)	(% of total)	(millions)	(% of total)
1. Union	2.56	54.5	6.70	62.0
1.1 Federal Government	2.51	53.5	5.44	50.5
1.2 DNC	. .	. .	1.01[b]	9.3
1.3 IAA	. .	. .	.12[c]	1.1
1.4 Social Security	.04	1.0	.12	1.1
2. States	1.48	31.6	2.80	25.9
3. Municipalities	.65	13.9	1.31	12.1
4. Total Public Sector (1 + 2 + 3)	4.69	100.0	10.81	100.0

Source: Federal, state and municipal figures from: Brazil, IBGE, *Anuário Estatístico—1949*, p. 545; DNC figures from: Taunay, *História do Café*, p. 475; IAA figures from: Brazil, IAA, *Anuário Açucareiro—1941*, p. 40; social security figures from: Brazil, IBGE, *Anuário Estatístico—1939/40*, p. 1409. Computations by the author.

[a]Two calendar years.

[b]Coffee purchases only from February 17, 1933, to December 31, 1934.

[c]Sugar purchases only adjusted to calendar years.

institutes.[47] Even though budgetary expenditures of the federal government fell in relation to total public expenditures, the Union as a whole increased substantially in fiscal importance. Both the states and the municipalities fell in relative importance during the years of the Provisional Government, but it appears that the former experienced the greatest relative decline. Unfortunately, little can be surmised about the size of the public sector in relation to the national product due to the lack of reliable output data. The estimates of NNP calculated by Pelaez, however, indicate that the public sector did grow as a percentage of that social account. Computations made by the present author revealed that public sector expenditures increased from about 24 per cent of the NNP in 1930 to about 27 per cent in 1933-34.[48]

The Return to Constitutional Democracy, 1934-37

National rule through the Provisional Government came to an end on July 16, 1934, when Brazil promulgated

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[47]State controlled semiautonomous institutes did exist at the time (the Cacau Institute of Bahia, for example), but were of little relative financial importance.

[48]Since the expenditures contain transfers and the NNP does not, these percentages tend to overstate the relative size of the public sector. For more detail on measuring the share of the public sector see R. Marris, "A Note on Measuring the Share of the Public Sector," *Review of Economic Studies*, XXII, No. 59 (1954-55), 214-19.

its second constitution since the founding of the republic. Although this new document restored a semblance of federalism to the country by returning some of the lost state and municipal autonomy, Getúlio Vargas remained in power as president through his election by the Constituent Assembly.

The role of the federal government was not significantly curtailed by the 1934 Constitution as compared to its status during the period of the Provisional Government, and was certainly enhanced when compared to its status in the 1891 Constitution. The interventionist role of the state which had been developed during the three years following the 1930 Revolutions was codified almost intact (see Chapter III) even though federal political controls over the states and municipalities were somewhat relaxed. The semiautonomous institutes (the DNC, IAA and social security system) which had expanded so rapidly in the 1930-33 period were also retained in the 1934-37 period and, in fact, assumed a growing fiscal importance. Nevertheless, the public sector during these latter years was characterized by a "vegetative, routine and conformist" growth as contrasted to the innovations of the Provisional Government.[49]

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[49]Mário Wagner Vieira da Cunha, *O Sistema Administrativo Brasileiro, 1930-1950* (Rio de Janeiro: INEP—Ministério de Educação e Cultura, 1963), p. 69.

The Public Finances, 1934-37

Effects of the 1934 Constitution

Due to the short duration of the 1934 Constitution, its provisions pertaining to the public finances (see Chapter III) only assumed real importance at the end of the 1934-37 period since they were to go into effect on January 1, 1936.[50] It is clear, however, that the municipalities substantially improved their financial positions as a result of these provisions. Table 15 readily illustrates this point. While the municipal system in 1935 was collecting little more than it had in 1931, by 1937 the rate of growth of municipal revenues had outstripped that of the states. In commenting on this phenomenon, a noted Brazilian financial expert has stated:

> You can, with justice, mark the document of 34 as the first of our constitutions which gave financial stability to local finances. If it was not the ideal, it was at least a great advance in relation to the past regime. And there is no doubt that, with all their defects, the taxes entrusted to the municipalities, when fully taken advantage of, enabled them to enjoy a satisfactory supply of revenue.[51]

The states, on the other hand, appeared to benefit little from the provisions of the 1934 Constitution. Export taxes, the leading source of state revenue during the

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[50]Transitory Provisions, Art. 6, Para. 1.

[51]Valentim F. Bouças, "Os Municípios e a Discriminação de Rendas," *Revista de Finanças Públicas*, XII, No. 141 (1952), 3-4.

TABLE 17

Federal, State and Municipal Revenues, 1935-37
(in contos de réis; index, 1931 = 100)

Year	Federal[a]		State[b]		Municipal	
	(millions)	Index	(millions)	Index	(millions)	Index
1935	2723	155	1881	141	451	109
1936	3127	178	2101	157	608	147
1937	3462	197	2135	160	673	163

Source: Brazil, IBGE, *Anuário Estatístico—1949*, p. 545. Indexes computed by the author.

[a]Excludes the semiautonomous institutes.

[b]Includes the Federal District.

First Republic, had been declining rapidly in importance since the early 1930's due primarily to adverse international market conditions. After 1935, however, their importance diminished even more because of the constitutional prohibition of internal export taxes, an especially lucrative source of state income during the pre-1930 period (see Chapter III). As a result, sales taxes became the dominant state revenue, comprising 17 per cent of their total incomes in 1936.[52] Export taxes had fallen to 12.5 per cent of the total in the same year.[53]

Both the states and the municipalities lost their freedom to obtain another source of revenue which had been important during the First Republic, namely, foreign credit. As mentioned in Chapter III, the 1934 Constitution called for prior approval by the Federal Senate of any foreign loans contracted by state and municipal governments. Although it is doubtful that these units could have obtained much credit from abroad during the Depression years, this constitutional provision set a precedent which was maintained in future constitutions.

Service on the external debt, however, which had been almost completely suspended during 1932 and 1933 was

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[52] Brazil, IBGE, *Anuário Estatístico—1939/40*, p. 1417.

[53] *Ibid.*

partially resumed between 1934 and 1937. On the basis of the "Aranha Plan," initiated in February of 1934, interest payments on the federal, state and municipal foreign debts were to be paid from April, 1934, to March, 1938. The payments were to be in accordance to a classification of bonds into eight groups, with group 1 bonds receiving full service and group 8 bonds receiving no service. This plan remained in effect until November, 1937, when exchange shortages once again forced massive defaults.[54]

The Problem of Regional Fiscal Adjustment Renewed

The controversy over the regional distribution of federal revenues and expenditures which was evident during the First Republic was renewed in the mid-1930's. The inequalities of production and wealth made clear by the 1920 census were maintained during the Vargas era and, in fact, appeared to have widened.

Spurred by the relative increase in the prices of imported goods through exchange depreciation and tariffs and the maintenance of internal demand through the coffee support program and the Reajustamento Econômico, national industrial production increased rapidly during the 1934-37 period.[55] The regional distribution of this production,

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[54]Ganzert, "Industry, Commerce, and Finance," p. 294.

[55]Brazil, IBGE, *Anuário Estatístico—1939/40*, p. 1318.

however, was even more lopsided than it had been in 1920. As revealed by Table 16, the South was the only region which significantly increased its relative position in terms of industrial production between 1920 and 1938. This regional data, however, conceal some important changes among the relative positions of individual states. With two minor exceptions (Ceará and Goías) and two major exceptions (Minas Gerais and São Paulo), all of Brazil's states declined in industrial importance during the period under consideration.

São Paulo, by a wide margin Brazil's richest state, increased its share in the nation's industrial production from 31.5 per cent to 42.2 per cent of the total. Minas Gerais, while of lesser importance, increased its share from 5.5 per cent to 11.3 per cent.[56]

Other available statistics for the 1930's also point to a continued concentration of wealth in the southern and eastern regions. Estimates for 1939, for example, show that the South and East accounted for 46.7 and 31.9 per cent, respectively, of the national income.[57] The same data reveals that among the states, São Paulo was the leader, accounting for 31.1 per cent of the total. The Federal District, Rio Grande do Sul and Minas Gerais followed

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[56]Jobim, *Brazil in the Making*, p. 76.

[57]"Brazil's National Accounts—New Estimates," *Conjuntura Econômica*, international ed., XVI, No. 10 (1969), 51.

TABLE 18

Regional Distribution of Industrial Production, 1920 and 1938 (per cent of national total)

Region	1920	1938
North	1.2	.9
Northeast	15.8	9.7
East	34.4	30.7
South	47.6	57.5
Central West	.3	.4

Source: Computations by the author based on data in Jobim, *Brazil in the Making*, p. 96. Figures may not add to 100 per cent because of rounding.

in importance but each one accounted for much less than São Paulo's total.

São Paulo's growing supremacy in almost every indicator of production, wealth and income made it an obvious source of federal tax revenue. As a result, the constant complaint of the Paulistas during the First Republic that they were being subjected to federal tax encroachment (see Chapter III) was continued into the 1930's. The Paulista delegation to the Constituent Assembly drafting the 1934 Constitution, in fact, used this argument in an effort to prevent a reduction in the revenue sources allocated to the states. As proof of their contention, Alcantara Machado, the leader of the Paulista delegation, cited data which showed that in 1931, federal revenues from excises alone exceeded São Paulo's entire state revenues. He also showed that federal stamp tax collections exceeded total state revenues in Minas Gerais and that federal income tax collections exceeded total state revenues in Rio Grande do Sul.[58]

Articles appearing in São Paulo newspapers between 1934 and 1937, however, made it clear that the Paulistas were less concerned about the absolute amount of federal taxes collected in their state than in their disproportionately small share of federal expenditures. In this respect,

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[58]Palmer, "Freight Cars," p. 66.

one such article contended that 83 per cent of all federal taxes collected in São Paulo were spent in other states.[59] The following table would tend to corroborate that São Paulo was indeed financing a substantial amount of federal services in other states. Although the data in the table are for only one year, the relative magnitudes involved are probably representative of the period.

While other states in other regions, such as Pernambuco and Rio de Janeiro, experienced a net outflow of income through the federal fiscal mechanism, only the South sustained a net outflow for a region as a whole. Furthermore, the state of São Paulo accounted for most of this outflow. The Paulistas did receive per capita federal expenditures in excess of the national average (excluding the Federal District), but their per capita tax burden was by far the highest in the nation.

With the exception of the Federal District, then, it would appear that the South (especially São Paulo) was financing a considerable portion of federal services in the poorer regions of Brazil.[60] Although no systematized

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[59] *O Estado* (São Paulo), September 24, 1937, cited by Palmer, "Freight Cars," p. 68.

[60] The tax burden of Minas Gerais is undoubtedly understated due to the import duties collected in ports of other states which were passed on to the Mineiros.

TABLE 19

Regional Distribution of Federal Revenues and Expenditures, 1936

State and Region	Revenues per capita (milréis)	Expenditures per capita (milréis)	Net Inflow (+) or Outflow (-) (contos de réis)
NORTH			+8,308
Amazonas[a]	18.1	26.6	+4,380
Pará	14.8	17.1	+3,478
NORTHEAST	18.9	19.0	+13,185
Maranhão	11.3	20.6	+11,013
Piauí	7.1	18.4	+9,621
Ceará	22.2	25.0	+4,710
Rio Grande do Norte	13.5	23.3	+7,647
Paraíba	12.9	16.1	+4,508
Pernambuco	30.2	17.8	-37,251
Alagôas	9.3	15.7	+7,838
Sergipe	13.4	22.6	+5,099
Bahia	17.6	22.3	+19,868
EAST			+838,373
Espírito Santo	8.9	17.7	+6,257
Rio de Janeiro	30.3	22.0	-17,156
Federal District[b]	91.4	136.4	+791,713
Minas Gerais	7.3	14.7	+57,559
SOUTH			-795,351
São Paulo	130.9	25.8	-714,241
Paraná	31.0	22.3	-9,023
Santa Catarina	25.9	25.8	+127
Rio Grande do Sul	44.5	21.3	-72,214
CENTRAL WEST			+14,048
Mato Grosso	5.8	27.6	+8,126
Goiás	7.3	15.2	+5,922
BRAZIL	73.7	76.1	. . .
(excluding Fed. Dist.)	37.5	20.4	. . .

Source: Federal revenue and expenditure data from Brazil, IBGE, *Anuário Estatístico—1937*, pp. 797-98. Population data from Brazil, IBGE, *Anuário Estatístico—1939/40*, pp. 1293-96. Computations by the Author.

[a]Includes the territory of Acre.

[b]Includes all expenditures of the Navy Ministry and the agency of the federal treasury in London. Expenditures of the War Ministry have been distributed among the states on a per capita basis.

program of regional development was enacted during the Vargas era, sporadic attempts were made to directly aid the North and Northeast. Federal activity in the North was primarily concerned with rejuvenating the regional economy after the decline of the rubber industry (see Chapter II). In this respect, the national government created administrative entities to provide credit and supplies and to mobilize the labor force.[61] In the Northeast, federal aid was directed mainly toward combatting the effects of the recurrent droughts in the region.[62] In fact, the instability of revenues to be allocated to the federal drought assistance program was one of the deciding factors in including the provision in the 1934 Constitution calling for the earmarking of tax revenues for this purpose.

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[61]These services, however, were mainly provided after 1940 in response to the increased wartime demand for rubber in the United States. See Andrade, *História Administrativa*, II, Ch. 22, *passim*.

[62]Robock, *Brazil's Developing Northeast*, p. 75 and Hirschman, *Journeys Toward Progress*, pp. 38-42.

CHAPTER VI

BRAZILIAN FISCAL FEDERALISM IN PRACTICE (3): THE ESTADO NÔVO, 1937-45

The period from 1934 to late 1937 proved to be a brief interlude in Vargas' dictatorship. Beginning in 1935, threats from the Left, Right and from the "old guard" state politicians contending for power were in widespread evidence. Vargas responded by manipulating these interests against one another and by convincing the Congress to declare almost a continuous "state of siege." This latter tactic made it possible for him to intervene in the affairs of the states and to repress "subversives." Suspicions that Vargas did not intend to let national elections be held in 1938 were seen to be well founded when in November of 1937, a military supported coup installed him once again as dictator of Brazil.[1]

On the day of the coup a new constitution was promulgated which returned the nation to the decree rule of the early 1930's. As a result, federalism, which had briefly emerged during the tenure of the 1934 Constitution, was replaced by a "decentralized unitary" form of government

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[1]Skidmore, *Politics in Brazil*, pp. 21-23.

which lasted until 1945.[2] State autonomy, symbolically destroyed by a public burning of state flags was actually destroyed by the reemergence of the Interventor system.

Getúlio Vargas expanded the authority and influence of the national government throughout the Estado Nôvo at a pace which even surpassed that of the Provisional Government period. With the 1937 Constitution serving as a guideline, a rash of decree laws was enacted which provided for massive state intervention in many areas. Along with this accelerated growth of federal authority, moreover, came a growth of bureaucracy. The federal government by 1943 was providing over 145 thousand jobs; a fact which gave immense patronage power to the President.[3]

The principal functional areas of federal intervention remained about the same as they had been since 1930. Commodity controls, labor, education and public welfare retained their importance. The national government, however, also embarked upon a program to actively encourage industrialization in contrast to the "spontaneous" industrialization

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[2]Herta, "Problems do Federalismo," p. 28.

[3]Cunha, *Sistema Administrativo Brasileiro*, pp. 129-30. In 1938, the Brazilian bureaucracy became institutionalized through the creation of the Administrative Department of the Public Service (*Departamento Administrativo do Serviço Público* or DASP), a federal agency combining the attributes of a civil service commission and budget bureau.

of the early 1930's which was largely a by-product of the coffee support program. In line with the nationalistic tenor of the Estado Nôvo, natural resource development also attracted public interest.

Economic and Financial Directives

During the 1937-45 period, the economic and financial policies of the federal government were primarily influenced by the effects of World War II. With the Depression waning, Vargas was forced to contend with new conditions, namely, the loss of overseas markets for the nation's exports, difficulties in obtaining needed imports and price inflation. Faced with these new problems, the federal government was prompted to reassess its previous policies and to adopt new strategies better suited to the changing situation.

Commodity Controls

Coffee and Sugar

The coffee and sugar industries, prime beneficiaries of previous public aid to agricultural producers, continued to be helped during the Estado Nôvo. The shortcomings of federal coffee policy in the early 1930's, however, became very apparent in 1937. The strategy of "price defense" had probably helped the coffee producers in the short-run, but

the artificial maintenance of high prices had stimulated production in other countries and Brazil began to rapidly lose its dominance in world markets. While accounting for almost 60 per cent of world coffee exports in the 1929-33 period, Brazil's share fell to less than 50 per cent in 1937.[4] In addition, coffee exports of about 12 million bags in 1937 were surpassed by the 17 million bags purchased and burned by the DNC in the same year.[5]

In 1937, a radical change in coffee policy was put into effect, the so-called "policy of competition." The export tax on the product was drastically lowered and the price of coffee fell sharply on the world market; from U. S. $.109 per pound in 1937 to U. S. $.076 in 1938.[6] The resulting increase in exports to 33.5 million bags in the 1938-39 period regained Brazil's world position, but also brought accusations of dumping from other producers.[7] The "policy of competition," however, was necessarily altered with the outbreak of World War II. With the loss of overseas markets previously accounting for 10 million bags of coffee, Brazil was forced to seek another strategy.

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[4]Wickizer, *Control Schemes*, p. 242.

[5]Andrade, *História Administrativa*, I, 79.

[6]Baer, *Industrialization*, p. 302.

[7]Andrade, *História Administrativa*, I, 80.

Brazilian coffee policy during World War II was built around the import quotas agreed upon at the Inter-American Coffee Conference in 1940. As a result of this conference, the United States agreed to purchase a certain amount of Brazilian coffee annually.[8] In response, coffee prices rose to U. S. $.134 in 1942 and stayed at this level until 1945 due to the ceiling price set by the United States Office of Price Stabilization.[9] Although the DNC remained active throughout the 1940's, the newly created (1938) agricultural credit section of the Bank of Brazil assumed the major responsibility for financing the coffee sector. Total loans of this latter entity totaled 1.5 billion cruzeiros in the 1938-44 period.[10]

The sugar industry, not nearly as dependent upon export markets for its income as coffee, was still greatly affected by World War II. Wartime shortages of gasoline pointed out the advantages of a domestic alcohol industry based on surplus sugar and various decrees were enacted to foster its continued growth. In 1941, for example, the IAA resolved that importers of gasoline would be obliged to purchase domestically produced alcohol equal to 20 per cent

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[8]The quotas given to Brazil under this agreement were: 9.3 million bags in 1940-41, 10.6 million bags in 1941-42 and 11.6 million bags in 1942-43. *Ibid.*, p. 81.

[9]Henry W. Spiegel, *The Brazilian Economy: Chronic Inflation and Sporadic Industrialization* (Philadelphia: Blakiston Company, 1949), p. 177.

[10]Andrade, *História Administrativa*, I, 82.

of their gasoline imports. Decree-law 4,722 of September, 1942, declared the alcohol industry to be an "industry of national interest" and authorized the IAA to fix a minimum price per liter of alcohol and to regulate its production in the national interest. In addition, Decree-law 4,825, enacted in the following month, contracted the Bank of Brazil to supply up to 80 million cruzeiros of credit annually for the financing of sugar and alcohol development.[11] Although sugar and alcohol policy continued to be regulated by the IAA, the Bank of Brazil gradually assumed the bulk of its financing. Between 1938 and 1944, it supplied credit to sugar producers totaling over 622.5 million cruzeiros.[12]

Other Commodities

The administrative organization favored by the federal government for dealing with the problems of coffee and sugar, namely, the semiautonomous institute, was extended to other commodities during the Estado Nôvo. In 1938, the federal government intervened to regulate the production and price of Brazilian tea (*mate*) through the creation of the National Institute of Tea (*Instituto National do Mate*).[13] This action was followed by the

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[11] *Ibid.*, p. 107.

[12] *Ibid.*, p. 91.

[13] Decree-law no. 375 of April 13, 1938.

establishment of similar institutes for the regulation of salt (*Instituto Nacional do Sal*)[14] and pine (*Instituto National do Pinho*)[15] in 1940 and 1941, respectively. Although of lesser importance than the analogous coffee and sugar regulatory agencies, they nevertheless represented an expanding federal influence in the Brazilian economy.[16]

Federal intervention in the development and regulation of Brazil's mineral and water resources also received considerable attention during the Estado Nôvo. In line with the nationalistic tenor of the 1934 and 1937 Constitutions as well as the Code of Mines and Code of Waters, Vargas sought to retain the country's natural resources for exploration and exploitation by Brazilian citizens only. To this end, he created the National Petroleum Council (*Conselho Nacional do Petróleo*) in 1938[17] and the National Council of Water and Electric Energy (*Conselho Nacional de Águas e Energia Elétrica*) in 1939.[18] Both administrative entities were vested with ample regulatory powers and were financed through special taxes.[19]

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[14]Decree-law no. 2,300 of July 10, 1940.

[15]Decree-law no. 3,124 of March 19, 1941.

[16]Spiegel, *Brazilian Economy*, pp. 223-24.

[17]Decree-law no. 395 of April 29, 1938.

[18]Decree-law no. 1,285 of May 18, 1939.

[19]Andrade, *História Administrativa*, II, 73-74; 178-79.

Public Enterprise

During the 1937-45 period, there was an increasing tendency for the federal government to directly and indirectly promote national industrial development. As expressed by Thomas Skidmore, "the Estado Nôvo's repudiation of political liberalism carried with it a willingness to deviate from the doctrine of economic liberalism."[20] Although indirect stimulants to industry through state controls over wage policy, foreign exchange, taxes and capital sources were accentuated after 1937, perhaps the most dramatic evidence of government participation was in the creation of several semipublic industrial enterprises (companhias mistas).

The first of these companhias mistas, the National Iron and Steel Company (*Companhia Siderúrgia Nacional*), was established in 1941[21] upon the recommendations of an executive commission set up in the preceding year. The initial capital of 500 million cruzeiros (raised to 1 billion cruzeiros in 1944) was purchased by semipublic institutional investors (including some social security institutes and federal savings banks), the federal government itself and some 22,000 private citizens.[22] In addition, the

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[20]Skidmore, *Politics in Brazil*, p. 43.

[21]Decree-law no. 3,002 of January 30, 1941.

[22]Spiegel, *Brazilian Economy*, p. 210.

American Export-Import Bank granted loans to the company totaling 45 million dollars in return for the use of Brazilian bases during the war.

The second companhia mista to be formed during the 1940's was the Doce River Valley Company (*Companhia Vale do Rio Doce*), a firm designed to supply iron ore to the United States and Great Britain.[23] Also receiving credit from the Export-Import Bank, the enterprise's initial capital subscription of 200 million cruzeiros was purchased by the federal government (55 per cent) and by semipublic institutional investors (45 per cent).[24] In addition, the company received guarantees of a minimum price for iron ore from American and British importers.[25]

A third corporation, the National Alkali Company (*Companhia Nacional de Álcalis*), was founded in 1943.[26] Having a capital subscription much smaller than its predecessors, this company was created to develop the production of caustic soda. Its shares were purchased by the federal government (51 per cent) and by the National Salt Institute (49 per cent).[27]

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[23]Decree-law no. 4,352 of June 1, 1942.

[24]Spiegel, *Brazilian Economy*, p. 209.

[25]Andrade, *Historia Administrativa*, II, 142.

[26]Decree-law no. 5,684 of July 20, 1943.

[27]Andrade, *Historia Administrativa*, II, 225.

In October of 1945, Vargas signed a Decree-Law creating the São Francisco River Valley Hydroelectric Company (*Companhia Hidroelétrica do Vale do São Francisco* or CHESF). Inspired by the American TVA, the CHESF sought to harness the power of the Paulo Afonso Falls and double the electric power capacity of the Northeast.[28] Of its original capital subscription of 400 million cruzeiros, all of its voting shares (200 million cruzeiros) were to be held by the federal government with the rest to be purchased by the social security institutes and federal savings banks.[29] In addition to these four companhias mistas, the Brazilian government also operated the National Motor Factory (*Fábrica Nacional de Motores*), a large firm producing aircraft engines during the war.

Economic Planning

As a part of its wartime mobilization policy, Brazil also embarked upon a limited program of public economic planning. Primarily directed toward alleviating shortages and bottlenecks associated with the war economy, Vargas issued two decrees initiating "special plans" to coordinate

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[28]Robock, *Brazil's Developing Northeast*, p. 84.

[29]Andrade, *Historia Administrativa*, II, 82-83.

public investment.[30] Both decrees stressed the need for the development of basic industries connected with national defense and also emphasized the construction of highways and railroads to the seaboard.[31]

The first of these "special plans," the Special Plan of Public Works and Installation of National Defense (*Plano Especial de Obras e Aparelhamento da Defensa Nacional*), was in effect between 1939 and 1943. Conceived and administered by a number of DASP technicians, this plan consisted of separating expenditures on large-scale public works and national defense projects from the regular federal budget.[32] Throughout the five-year duration of this program, expenditures varied between 500 and 600 million cruzeiros, with the bulk of the spending being channeled through the Ministry of Finance and the Ministry of Transportation and Public Works.[33] Financing of the Plan was through sources

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[30]Decree-law no. 1,058 of January 19, 1939 and Decree-law no. 6,144 of December 29, 1943.

[31]Frederic William Ganzert, "Wartime Economic Conditions," in *Brazil*, ed. by Lawrence H. Hill (Berkeley: University of California Press, 1947), p. 312.

[32]Roberto de Oliveria Campos, "A Retrospect Over Brazilian Development Plans," in *The Economy of Brazil*, ed. by Howard S. Ellis (Berkeley: University of California Press, 1969), p. 323.

[33]Brazil, IBGE, *Anuário Estatístico—1948*, p. 476. Spending on the Plan amounted to an average of 8 to 10 per cent of the regular budgetary federal expenditures.

of income also not included in the regular federal budget. Most important of these revenue sources was the tax on exchange operations, although profits on banking operations of the national treasury were also lucrative.[34]

The second wartime plan, the Plan of Works and Equipment (*Plano de Obras e Equipamentos*), began in 1944 and lasted until the end of 1946. Operating in essentially the same manner as the first plan, it was also concerned with consolidating federal expenditures on public works projects. Spending on the Plano de Obras e Equipamentos was significantly larger than on the previous plan, however, varying between 949 million cruzeiros in 1944 and 872 cruzeiros in 1946 when it began to be incorporated into the regular budget.[35] Financing was from sources similar to those of the first plan, although it continually ran deficits throughout its three years of operation.[36]

International cooperation was also utilized in Brazil's first attempts at planning, but with only moderate success. The Taub Mission (1942) drew up a ten-year program of investment priorities which never materilized. The American Technical Mission (or Cooke Mission), following

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[34] *Ibid.*, p. 473.

[35] *Ibid.*, p. 476.

[36] *Ibid.*, p. 473.

in 1943, made recommendations for the sectoral development of transport, fuel, textiles, minerals, chemicals and education, but failed to quantify the capital outlays needed to achieve these goals.[37]

Social Directives

In addition to directly intervening in the economy to protect the interests of various commodity producers and to promote national industrial development, Vargas also intensified his efforts in the fields of labor, social welfare and education. It is questionable, however, whether the President's motives for increasing legislation in these areas was altogether altruistic. The growing industrial sector of the economy and the accompanying urbanization necessitated the political support of labor in Vargas' continuing attempts to reduce the influence of the rural oligarchy.

Labor and Social Welfare

During the Estado Nôvo, organized labor became tightly controlled by the federal government. In line with

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[37]Campos, "Development Plans," p. 323. Some comments on the findings of the American Technical Commission written by its chief can be found in Morris L. Cooke, *Brazil on the March--A Study in International Cooperation* (New York: McGraw-Hill Book Co., Inc., 1944).

the "progressive" labor policy outlined in the 1937 Constitution, trade unions (*sindicatos*) were recognized by the government, but once recognized they came under the strict supervision of the Labor Ministry. Unions not recognized by the government were permitted to exist, but were not allowed the use of the labor courts and were also unlikely to be financially strong.[38]

The finances of the unions were based on the *imposto sindical* or trade union tax. This tax represented a compulsory contribution of one day's pay a year by each worker, payable whether or not the particular worker officially belonged to a union. The funds collected through the imposto sindical were to be used for providing social services to the workers, but throughout the Vargas era they were one of the most effective means of government control over organized labor.[39] Although union revenues were not technically public, the Labor Ministry exercised various controls over their use. When considered with the transfer payments made through the social security institutes, they represented increasing "direct federal contact at the local level, thereby undermining the foundation of the *política dos*

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[38]Robert J. Alexander, *Labor Relations in Argentina, Brazil, and Chile* (New York: McGraw-Hill Book Company, Inc., 1962), pp. 59-60.

[39]*Ibid.*, pp. 60-61; 85-86.

governadores ('politics of the governors') which had prevailed before 1930."[40]

Besides increasing its control over the organizational structure of the trade unions, Vargas also introduced legislation providing for expanded social benefits and improved work conditions. Of fundamental importance in this respect was the growth of the social security system. Between 1937 and 1945, the number of workers directly benefiting from the system rose from about 1 million to about 3 million.[41] In addition, the revenues and expenditures of the institutes and funds comprising the system increased from 358 thousand cruzeiros and 124 thousand cruzeiros, respectively, in 1937 to 2.3 million cruzeiros and 990 thousand cruzeiros, respectively, in 1945.[42] The large financial reserves accumulated by these institutes and funds were utilized primarily for investing in buildings and real estate and also for purchasing shares in several semipublic industrial enterprises (see above).[43]

Other benefits to labor enacted during the Estado Nôvo included minimum wages (1941), an eight-hour day, paid

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[40]Skidmore, *Politics in Brazil*, p. 34.

[41]Brazil, IBGE, *Anuário Estatístico--1948*, p. 381.

[42]*Ibid.*

[43]Cardoso de Oliveira, "Social Security in Brazil," p. 379.

vacations and family assistance payments. All such legislation increased the paternal role of the State and Getúlio Vargas touted himself as *o pae dos pobres* ("father of the poor"). This paternal role was also seen in the educational policies of the period.

Education

The educational policies of the Estado Nôvo were primarily aimed at standardizing public instruction and adapting the curriculum to the changing needs of the nation. To this end, national guidelines were established by the Ministry of Education and Public Health with respect to primary, secondary and higher education. Research institutes were created to study Brazil's educational problems and subsidies and technical assistance were given to various states and municipalities for improving their systems. Although these latter two units were still to administer the bulk of the nation's public instruction, they were increasingly supervised by the federal government.

Of considerable importance during the Estado Nôvo was Vargas' emphasis on technical and vocational training. According to Fernando de Azevedo, "breaking with the intellectualistic and academic traditions of the country and raising technical and vocational education to the category of the first duty of the State, may be considered

the most revolutionary and democratic of the laws which have been promulgated in the field of education."[44] To accomplish this goal, the federal government encouraged or directly established industrial and commercial schools and required factories to provide vocational training to their employees.[45]

The success of federal educational policies during the Vargas era, referred to by Lourenço as being "unparalleled in the educational history of Brazil," is revealed in the following statistics.[46] Overall school enrollment increased from 2.5 million in 1933 to 4.2 million in 1945, while the population of the country increased by only 6 million. Although students enrolled in primary schools increased by one-third during this period, enrollment in secondary, industrial and commercial schools quadrupled.[47] The number of schools increased from 32,430 to 51,368 in the same period of time, with the most dramatic expansion to be noted in industrial and commercial schools. While only 196 industrial schools and 721 commercial schools existed in 1943, by 1945

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[44]Azevedo, *Brazilian Culture*, p. 470.

[45]Decree-law no. 1,238 of May 2, 1939.

[46]Manoel Bergstrom Lourenço Filho, "Education," in *Brazil*, ed. by Lawrence F. Hill (Berkeley: University of California Press, 1947), p. 145.

[47]Brazil, IBGE, *Anuário Estatístico--1949*, p. 480.

there were 1,368 of the former and 1,014 of the latter.[48] The new commitment of the federal government to education is also revealed by the relative growth of appropriations to the Ministry of Education and Public Health; from .4 per cent of the total budget in 1930 to 5.7 per cent in 1945.[49]

The Evolution of Budgetary Finances

In the preceding discussion of the Estado Nôvo, attention has been concentrated on the growth of the national government through means not included in the federal budget, i.e., through the autarquias and companhias mistas. Significant changes in the relative financial bases of the federal, state and municipal governments, however, may also be noted.

As was mentioned previously, the municipalities appeared to have benefited greatly from the financial arrangements of the 1934 Constitution (see Table 17, Chapter V), increasing their revenues at a considerably faster rate than either the federal government or the states. This rapid growth continued into the early years of the Estado Nôvo and by 1940 the municipalities were accounting for 11.3 per cent

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[48] *Ibid.*

[49] Brazil, IBGE, *Anuário Estatístico—1939/40*, p. 1412 and Brazil, IBGE, *Anuário Estatístico—1947*, p. 468.

of total budgetary revenues as compared to an 8.9 per cent share in 1935. The improved relative position of this level of government, moreover, seems to have been at the expense of the states whose relative position fell from 37.2 per cent to 32.8 per cent between these two dates.[50]

After 1940, however, the relative financial positions of these two administrative units began to reverse themselves. By 1945, the municipal share of total budgetary revenues had fallen to 8.2 per cent while the states' share had risen to 36.1 per cent. The major explanation of this trend can be traced to the inflation which characterized the Brazilian economy during the war years and the difficulties experienced by the municipalities in adjusting their tax bases to this contingency.

Starting in 1939 and continuing to the present day, Brazil has been plagued by rather intense inflation. Due to such factors as an increasing money supply and various externally induced problems, the cost of living in the country more than doubled between 1939 and 1945, growing at a rate of 10 to 20 per cent annually.[51] Possessing the most inflexible taxes for its revenues and having limited

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[50]Brazil, IBGE, *Anuário Estatístico—1949*, p. 545.

[51]Joint Brazil-United States Economic Development Commission, *Development of Brazil*, pp. 37-45.

access to credit, the municipalities were unable to successfully cope with this problem.

As revealed by Table 20, the municipal system collected substantially less revenue in 1945 than it had in 1939 in real terms. Although federal revenues also declined in real terms, they had almost reached their prewar level in 1945. The federal government, of course, was eminently more able to engage in deficit financing. The states, on the other hand, actually improved their position during the war.

The deterioration of the municipal tax base was due to the rigidity of the major local taxes and the generally poor quality of tax administration. The three most important municipal taxes—the tax on industries and professions, the tax on buildings and the license tax—were all highly defective taxes. Although they were commonly levied on an *ad valorem* basis (according to the particular municipality), poor administration prevented an accurate revaluing of the tax bases as a result of inflation. The tax rates on buildings, moreover, had reached their upper limits in many localities.[52]

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[52]Gerson da Silva, *Sistema Tributário Brasileiro* (2nd ed.; Rio de Janeiro: Edições Financeiras, S. A., 1948), p. 91.

TABLE 20

Indexes of Federal, State and Municipal Revenues at 1939 Prices (Index; 1939 = 100)

Year	Federal	State	Municipal
1939	100	100	100
1940	102	100	104
1941	94	105	100
1942	88	107	95
1943	92	119	90
1944	100	116	79
1945	97	106	73

Source: Computed by the author on the basis of budgetary data in IBGE, *Anuário Estatístico—1949*, p. 545 and price indexes in Joint Brazil-United States Economic Development Commission, *Development of Brazil*, p. 40.

The states generally maintained or improved their financial positions during the war years because of their highly price-elastic sales taxes and taxes on the transfer of real property *inter vivos*. The first of these taxes, characterized by Gerson da Silva as being "flexible, easily collected and notably productive," rose from 45.1 per cent of total state revenues in 1940 to 57.4 per cent of the total in 1945.[53] Responding to the rising prices of taxed goods and increased rates in most states, collections of this tax almost tripled between 1940 and 1945. Revenues from the tax on the transfer of real property also rose appreciably during this period, due to the rising money value of the tax base and the accelerated rate of transactions.[54]

The federal tax base was also affected by the rapid price inflation of the 1940's. Excises, the most important federal taxes at the time, benefited from the industrial activity of the 1940-45 period, but the growth of revenues from this tax was slowed by its imposition at specific rather than *ad valorem* rates. The income tax, however, which had comprised only 14.5 per cent of federal tax revenues in 1940, accounted for 30.6 per cent of the total

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[53] *Ibid.*, pp. 76-77.

[54] *Ibid.*, p. 74.

in 1945. Revenues from the income tax increased over sixfold (in current cruzeiros) during the war as the number of taxpayers increased and tax rates elevated. Import duties, the second most important federal tax in 1940, comprising 34.3 per cent of total federal revenues, fell to third place by 1945 (after excises and income taxes) at 13.8 per cent of the total.[55] The wartime decrease in imports and the specific tax rates had greatly diminished their productivity.

Summary of the Vargas Era

The Vargas era witnessed a radical change in the nature of Brazilian federalism. The national government, which before 1930 had performed only minimal functions, considerably expanded its sphere of influence at the expense of the previously powerful states. Throughout most of the 1930-45 period, the states and municipalities were without political autonomy and hence were helpless in preventing this federal encroachment.

The means by which the federal government achieved this centralization varied during the fifteen years of Vargas' rule. In addition to assuming some of the responsibilities formerly exercised by the states, e.g., labor,

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[55] *Ibid.*, p. 65.

education and commodity controls, the national government entered fields which had never before involved any level of government. These new areas of public interest, often administered through extra-budgetary semiautonomous institutes and enterprises, included a greatly expanded social security system, state industrial firms and natural resource development. The federal government also increased its power through political patronage, priorities for obtaining foreign exchange, wage policy and its controls over capital sources.

The 1930-45 period was also characterized by changes in the relative importance of different revenue sources. Taxes on the foreign sector, which had been of prime importance to the federal government and the states during the First Republic, were superceded by taxes on the internal economy. At the federal level, income taxes attained prominence for the first time during World War II and, at the state level, sales taxes became the major source of revenue. The municipalities were provided with exclusive revenue sources during this period and it appeared that local government would finally achieve a secure financial base. Wartime inflation and poor tax administration, however, soon dispelled this hope. By the end of 1945, the municipal system was once again impoverished and it became apparent that a new division of revenue sources was needed to save local government in Brazil.

CHAPTER VII

BRAZILIAN FISCAL FEDERALISM IN PRACTICE (4): THE POSTWAR YEARS, 1946-64

By the end of World War II, Brazilian federalism had evolved to a point of pronounced centralization. The fifteen years of Vargas dictatorship, coupled with the twin crises of depression and war, had fostered a national government of formidable strength and pervasiveness. Although Brazil attained democratic government in 1946, the precedents set during the 1930-45 period proved impossible to reverse. The growth of the public sector accelerated in the postwar years, an era characterized by a large-scale drive for economic development.

One of the purposes of the present chapter is to analyze the growth of the Brazilian national government in the postwar years, especially those aspects of this growth which are related to the development process. Other significant trends in fiscal federalism will also be discussed. The most important of these center around the efforts to find a solution to the problem of fiscal adjustment, both "vertical" (among the three governmental levels) and "horizontal (between the regions). The preceding chapters have demonstrated that the Brazilian government had never

been able to successfully cope with these two related problems.

The Transition to Democratic Government

Before proceeding to an analysis of the federal finances, it is useful to note the circumstances surrounding Brazil's transition from fifteen years of Vargas rule to almost two decades of democratic government. The men and ideas which came to prominence during this period were to have a lasting effect on the nature of Brazilian federalism.

Getúlio Vargas was removed from the presidency in 1945 by a military coup. Shortly thereafter the nation attained a new constitution and its first popularly elected president in two decades. The Constitution of 1946, as described in Chapter III, incorporated the desires of the liberals, but also retained much of the administrative apparatus originally developed by Vargas. The philosophy of the new document, however, rejected many of the totalitarian features of its predecessor. The resulting product was a hybrid most closely resembling the Constitution of 1934 and as such did not foresee a return to the pre-1930 "política dos governadores."

The framers of the Constitution of 1946 were highly influenced by the tenets of laissez-faire economics and as a consequence sought to diminish the direct and indirect

federal intervention in the economy which had characterized the Estado Nôvo.[1] As will be revealed later in the present chapter, however, this initial commitment to economic liberalism proved to be impossible to maintain in the face of growing demands for accelerated national development. The seeds of public economic planning, moreover, were already firmly implanted in the Constitution through its provisions calling for earmarking of funds for the development of the Northeast and Amazon regions.

Perhaps the most important aspect of the Constitution of 1946 as related to fiscal federalism was its emphasis on intergovernmental financial cooperation. During the First Republic, the federal government and the states were essentially competitors while during the Vargas era the former was almost completely dominant over the latter. The municipal system, which had been practically ignored during the First Republic and overshadowed by the federal government during the 1930's and early 1940's, received considerable attention after World War II.

Direct contact between national and local government was formalized by the Constitution as rather widespread "municipalist" sentiment fostered genuine concern over the creation of a viable municipal system. The new Constitution,

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[1]Skidmore, *Politics in Brazil*, p. 69.

however, did not provide an "equal partnership" status for local government; it succeeded only in curbing state encroachments within the sphere of the municipalities. In reference to the place of local government in the federal system, the Constitution of 1946 "saw the states as the basic givers of power and structure, the federal government as the protector against excess, and the municipalities as the users of power."[2] Nevertheless, elaborate tax-sharing schemes and new revenue sources utilized after 1948 (to be discussed below) provided local government with resources which could be used to effectively realize their political autonomy as guaranteed by Article 28 of the Constitution.

The Public Sector in the Postwar Years: An Overview

The phenomenal growth of the public sector must be regarded as one of the more important distinguishing characteristics of postwar Brazil. Building on the foundations established during the Estado Nôvo, government influence in the economy increased rapidly in absolute terms and relative to the national product between 1947 and 1964. The following statistics appear to confirm this hypothesis.

In the aggregate, the public sector's expenditures rose from 28.2 billion cruzeiros in 1947 to 5.4 trillion

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[2]Sherwood, *Grass Roots in Brazil*, p. 38.

cruzeiros in 1964.[3] Discounting for inflation, this meant about a three and a half-fold increase. Public sector expenditures also rose appreciably as a proportion of the GDP (gross domestic product). As shown in Table 21, column 3, total public purchases as a percentage of the GDP increased from 13.9 per cent in 1947 to 22.5 per cent in 1964. Moreover, total public purchases plus transfers and subsidies increased from 17.6 per cent to 30.3 per cent of the GDP during the same eighteen year period.[4] This latter figure can be compared with the government's share of the GDP in some randomly selected countries in 1964: United States, 27.3 per cent; Sweden, 37.3 per cent; Bolivia, 21.2 per cent; and Southern Rhodesia, 17.4 per cent.[5]

Although large budgetary deficits appeared during most of the postwar years, public revenues also increased substantially. In the aggregate, current receipts (mainly taxes) of the public sector expanded from 30.1 billion cruzeiros in 1947 to 4.3 trillion cruzeiros in 1964. Once

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[3]Including the expenditures of the companhias mistas would bring this latter total to 8.4 billion cruzeiros. Margaret H. Costa, "Planejamento do Setor Público em Países em Desenvolvimento," *Revista Brasileira de Economia*, XX, No. 2-3 (1966), 60.

[4]The companhias mistas were accounting for an additional 16 per cent of the GDP in 1964. *Ibid.*

[5]United Nations, *Yearbook of National Accounts Statistics—1965* (New York, 1966).

TABLE 21

The Public Sector and the Gross Domestic Product, 1947-64 (percentages)

Year	(1) TX/Y	(2) TX + CR - TR/Y	(3) E/Y	(4) E + TR/Y
1947	14.7	14.9	13.9	17.6
1948	15.2	15.7	15.8	19.5
1949	15.9	16.7	17.4	21.5
1950	15.7	15.3	17.4	21.5
1951	17.6	17.1	16.6	21.0
1952	17.5	16.4	17.1	22.0
1953	16.9	16.1	19.0	23.8
1954	18.7	17.1	18.2	22.9
1955	17.3	15.4	17.3	22.2
1956	18.7	15.5	18.2	24.0
1957	19.4	15.9	19.8	25.8
1958	21.9	18.1	20.4	26.9
1959	22.6	18.4	20.4	26.5
1960	22.9	20.5	22.7	28.6
1961	21.8	17.2	23.1	30.2
1962	21.4	15.7	24.0	31.8
1963	22.4	17.0	24.1	31.8
1964	23.6	15.2	22.5	30.3

Source: Adapted from Brazil, Ministério do Planejamento, Escritório de Pesquisa Econômica Aplicada, *The Brazilian Public Sector in the Postwar Period* (Rio de Janeiro, 1968), p. 21.

Notes:
- Y = gross domestic product.
- TX = taxes (direct and indirect).
- CR = current receipts other than taxes.
- TR = transfers and subsidies.
- E = government purchases (consumption and investment).

again discounting for inflation, we are still left with a two and a half-fold increase. Taxes also increased significantly in relation to the GDP; from 14.7 per cent in 1947 to 23.6 per cent in 1964 (see Table 21, column 1).[6] Due to the growing level of transfers and subsidies from the public to the private sector, however, the "net national revenue burden" (taxes plus other current receipts minus transfers and subsidies) did not exhibit nearly so large an increase; growing from 14.9 per cent in the former year to 15.2 per cent in the latter (see Table 21, column 2).

In addition to the absolute and relative growth of the public sector, there were also important changes in its structure. Of foremost importance in this respect was the marked decentralization of activity within the national government and the rising and falling fiscal importance of the municipalities. Both trends are suggested by Table 22.

As column 3 shows, the relative share of national (Union) government in total public sector expenditures rose between 1947 and 1964 (from 54.3 per cent to 58.4 per cent) while the share of the federal government fell (from

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[6]This latter figure is quite high in comparision to other countries with a similar level of per capita income. In 1960, Brazil ranked third out of a sample of fifteen countries in the $150-299 per capita income range. See Hinrichs, *Tax Structure Change*, p. 15.

TABLE 22

Expenditures of the Public Sector's Component Parts, 1947-64 (as percentages of total)

Year	(1) Federal	(2) Autarquias	(3) = (1 + 2) Union	(4) State[a]	(5) Municipal
1947	42.6	11.7	54.3	39.4	6.4
1948	42.0	14.8	56.9	37.0	6.2
1949	43.4	14.7	58.1	34.4	7.5
1950	41.7	14.6	56.3	36.2	7.6
1951	37.1	14.8	51.9	40.9	7.2
1952	35.0	14.7	49.7	42.2	8.1
1953	36.6	16.9	53.4	39.1	7.5
1954	33.5	18.5	52.0	40.6	7.4
1955	35.7	18.2	53.9	38.6	7.5
1956	41.3	17.0	58.3	34.3	7.4
1957	35.4	19.5	54.9	37.1	8.1
1958	35.6	19.0	54.6	37.3	8.1
1959	33.9	23.7	55.5	37.4	7.1
1960	34.3	20.2	54.5	39.2	6.2
1961	37.1	21.2	58.3	35.7	6.0
1962	37.0	21.6	58.7	35.4	5.9
1963	36.3	20.4	56.6	35.2	8.1
1964	36.9	21.5	58.4	34.0	7.5

Source: Computed by the author based on data from Fundação Getúlio Vargas, Centro de Estudos Fiscais, *O Setor Público Brasileiro nos Últimos Vinte Anos—Caderno Estatístico* (Rio de Janeiro, 1968).

[a]Including state autarquias.

42.6 per cent to 36.9 per cent). This trend is explained by the rapid growth of expenditures of the autarquias (especially the social security system) during this period.[7] Comprising only 11.7 per cent of total public sector expenditures in 1947, the autarquias were enjoying a 21.5 per cent share in 1964 (see Table 22, column 2). Their total expenditure of 1.2 trillion cruzeiros in the latter year was equivalent to over 6 per cent of the GDP.

Of additional importance at the national level were the semipublic companhias mistas which by 1964 were spending almost as much as the federal government and autarquias combined (3.0 trillion cruzeiros versus 3.2 trillion cruzeiros). Engaged in such fields as steel, petroleum and electric energy, the expenditures of these corporate entities increased from 9.9 per cent to 15.9 per cent of the GDP between 1960 and 1964 alone.[8] By adding the expenditures of the companhias mistas to those of

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[7]Between 1947 and 1964, expenditures of the social security system increased from 70 to 75 per cent of the total for all autarquias. FGV (Fundaçao Getúlio Vargas), CEF (Centro de Estudos Fiscais), *O Setor Público Brasileiro nos Últimos Vinte Anos—Caderno Estatístico* (Rio de Janeiro, 1968), Tables 1.2, 1.2.1 and II.

[8]Costa, "Planejamento," p. 60. A longer series of comparable data was not available to the present author.

the Union, we find that the national government was accounting for almost 75 per cent of total public sector expenditures in 1964.[9]

As was mentioned above, one of the intentions of the framers of the 1946 Constitution was to strengthen the fiscal position of the nation's municipal system. During most of the 1947-64 period it appears that they had succeeded. Between 1949 (when the effects of the new tax sharing schemes went into full effect) and 1958, the municipalities accounted for between 7.2 per cent and 8.1 per cent of total public sector expenditures (see Table 22, column 5). This can be compared with the 6.4 per cent and 6.2 per cent shares in 1947 and 1948. After 1958, the expenditures of the municipalities, while still growing in absolute terms, declined as a percentage of the public sector for four consecutive years. The major explanation of this phenomenon can be traced to the hyperinflation which characterized these years and the consequent erosion of the local tax and credit bases. In 1963 and 1964, the municipal system regained its previous relative position due primarily to a revamping of the tax sharing schemes (to be discussed in more detail in a later section).

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[9]For data on labor and capital expenditures of the companhias mistas in the 1947-65 period see: Arnaldo de Oliveira Werneck, "As Atividades Empresariais do Govêrno Federal no Brasil," *Revista Brasileira de Economia*, XXIII, No. 3 (1969), 89-108.

The states were certainly not as favored as the municipalities in the 1946 Constitution. Besides losing several taxes to the latter units, the states were also obliged to share tax proceeds with them (see Chapter III). As Table 22 illustrates, the states actually lost ground relative to the other units of the public sector between 1947 and 1964; from a 39.4 per cent share in the former year to a high of 42.2 per cent in 1952 to 34 per cent in 1964. Subjected to essentially the same credit constraints as the municipalities, the states were more protected from inflation because of their widespread use of the price-elastic sales taxes. Comprising less than 60 per cent of state tax proceeds in 1947, the revenues from sales taxes increased at a far more rapid rate than the revenues from other state taxes. As a result, they were accounting for almost 80 per cent of total state tax revenues in 1964.[10]

Parallel to decentralization within the national government, there also appears to have been a similar trend at the state level. Although information on this phenomenon is presently fragmentary, there was undoubtedly a rapid growth of state autarquias during the postwar period. By 1964, in fact, the formation of gross fixed capital by the

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[10] FGV-CEF, *Caderno Estatístico*, Table V. Also see: "Sales Tax—Most Important of all State Taxes," *Conjuntura Econômica*, international ed., VII, No. 11 (1960), 47-53.

state autarquias was equivalent to 46 per cent of total state capital expenditures (compared to less than 25 per cent in 1947).[11]

The Rise of the National Government

The postwar years were ones of rapid economic growth in Brazil. During this period, the real GDP almost tripled, with growth rates in some years exceeding 10 per cent (1964 and 1961).[12] As documented by Tables 21 and 22, the public sector grew at an even greater rate, significantly increasing its share in the national economy between 1947 and 1964. It is the purpose of the present section to trace the growing role of the national government during this period, especially in relation to the development process.[13] A discussion of the postwar attempts to strengthen the financial positions of the other units of government will be included in a later section.

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[11]FGV-CEF, *Caderno Estatístico*, Table II.

[12]"Brazil's National Accounts," p. 37.

[13]For Comprehensive studies of economic development in postwar Brazil see: Baer, *Industrialization*, esp. chs. 3-8; Nathaniel H. Leff, *Economic Policy-Making and Development in Brazil, 1947-1964* (New York: John Wiley and Sons, Inc., 1968); UN (United Nations), ECLA (Economic Commission for Latin America), "Fifteen Years of Economic Policy in Brazil," *Economic Bulletin for Latin America*, IX, No. 2 (1964), 153-214 and UN-ECLA, "The Growth and Decline of Import Substitution in Brazil," *Economic Bulletin for Latin America*, IX, No. 1 (1964), 1-61.

The Early Postwar Years, 1946-50

The commitment of the national government to actively promote economic development through industrialization did not arise immediately after World War II. In fact, the economic attitude of the government in 1946 even approached laissez faire.[14] Direct wartime controls over the economy were removed and the government opened up the country to foreign imports as an antiinflationary policy. This "hands off" approach, however, was shortly abandoned as pent-up internal demand quickly drained Brazil of its large reserves of foreign exchange built up during World War II.[15] With balance-of-payments difficulties besetting the nation, exchange controls were reinstituted in 1947 and were to last until 1953. In the immediate postwar years, however, the Brazilian national government was able to pay off the external debt contracted through earlier coffee support programs and also acquired the foreign-owned railway and maritime network connected with the coffee economy.

With the introduction of fixed multiple exchange rates in the late 1940's, the Brazilian economy began to experience import substitution industrilization although in a haphazard manner with virtually no sectoral coordination.

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[14] In this respect, the 17.6 per cent share of the GDP accounted for by the government in 1947 can be compared to its 21 per cent share in 1939. "Brazil's National Accounts," pp. 38, 40, and 44.

[15] Baer, *Industrialization*, pp. 45-46.

Due to an import duty structure with a specific incidence (reduced to very low real rates by wartime inflation), moreover, the federal government was unable to adequately tap the income flows generated by the foreign sector.[16] Partially as a result of this factor, the government was incapable of providing the social overhead capital needed by the growing industrial sector.[17]

The need for infrastructure development was recognized by the federal government, however, as evidenced by the ill-fated SALTE plan of coordinating public expenditures. Proposed in May, 1948, the plan was supposed to be in effect from 1950 to 1954. The total expenditures devoted to this plan were to approach 20 billion cruzeiros, with more than half of the resources to be used for the modernization of the nation's transportation system. Financing problems, however, caused the demise of the plan in 1951.[18] The semipublic *Companhia Siderúrgia Nacional*, which had been established by Vargas in 1941, did help to reduce potential bottlenecks in the supply of metal products. Beginning the production of coke in 1946 at the Volta Redonda plant, Brazil became the first Latin American nation to

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[16]The fixed exchange rates coupled with internal price inflation had greatly stimulated imports.

[17]UN-ECLA, "Fifteen Years," p. 157.

[18]Baer, *Industrialization*, pp. 61-63.

have a fully integrated coke-based steel mill by 1948. As a result, the national production of steel increased dramatically between 1945 and 1950; this was in turn accompanied by a marked decline in Brazil's dependence on its importation.[19]

The Return of Getúlio Vargas, 1951-54

In 1951, Getúlio Vargas returned to the Brazilian presidency for the first time through popular elections. During his term of office the national government started its initial deliberate attempts to promote economic development. The principal means through which the government manifested this intention were exchange policies which favored the industrial sector, the establishment of a development bank, the earmarking of revenues for infrastructure development and direct public participation in industrial production.

Much impetus to this goal of development was given by the Joint Brazil-United States Economic Development Commission which functioned in Brazil from 1951 to 1953.[20]

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[19]Werner Baer, "Steel and the Economy," in *The Economy of Brazil*, ed. by Howard S. Ellis (Berkeley: University of California Press, 1969), pp. 81 and 84.

[20]A similar group in the late 1940's made recommendations, but did not derive an overall plan. See: Joint Brazil-United States Technical Commission, *Report of the Commission* (Washington, D. C.: Government Printing Office, 1949).

This group of American and Brazilian technicians made an exhaustive study of the economy and drew up an integrated plan for infrastructure development (mainly in transportation and electric power).[21] Although the Commission's plan was never implemented, it did produce some favorable side effects. These included the creation of the semi-autonomous National Development Bank (*Banco Nacional do Desenvolvimento Econômico* or BNDE) in 1952, a revised National Road Plan,[22] a program for expanding electric power in the Northeast, the establishment of the Federal Electrification Fund,[23] a study of the coal industry and a program for modernizing the nation's merchant fleet and port facilities.[24]

Exchange policy also underwent substantial changes during the second Vargas era through a series of reforms initiated by the Superintendency of Money and Credit (*Superintendência da Moeda e Crédito* or SUMOC). Instruction 70 of SUMOC, in October of 1953, instituted an auction system

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[21]See Joint Brazil-United States Economic Development Commission, *Development of Brazil, passim.*

[22]Financed through earmarking proceeds from the "single tax" on fuels.

[23]Financed through earmarking proceeds from excises and the "single tax" on electric energy.

[24]UN-ECLA, "Fifteen Years," p. 157.

for obtaining foreign exchange whereby imports were grouped into five categories according to essentiality and then available exchange was sold to the highest bidder in each category.[25] Through this mechanism, the industrial sector was able to receive preferential treatment in the importation of capital equipment and at the same time the federal government was able to realize additional revenues (the purchasing of foreign exchange was made a monopoly of the official Bank of Brazil).[26]

The early 1950's also witnessed the growth of the national government as an entrepreneur. Of foremost importance in this respect was the creation of a companhia mista called PETROBRÁS which was given a monopoly over oil drilling rights and any new refineries. With the beginning of operations of this entity in 1954, the public sector had expanded its ownership over a large segment of the country's basic industries and transportation sector.

By the end of Vargas' term, however, deficit public spending, very rapid increases in the minimum wage and large export surpluses had greatly stimulated price inflation. From a relatively low 6.4 per cent rise in prices in 1948-49,

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[25]Baer, *Industrialization*, p. 53.

[26]Profits from these exchange transactions provided the federal government with 12.2 billion cruzeiros in 1954 alone. FGV-CEF, *Caderno Estatístico*, Table V.

inflation had grown to almost 15 per cent in 1953 (see Appendix, Table A-3). Moreover, the real rate of growth in the GDP had fallen to 2.5 per cent in the latter year from an average rate of over 6 per cent in the preceding five years (see Appendix, Table A-2). Although the real growth rate rebounded to a phenomenal 10.1 per cent in 1954, prices advanced at an annual rate of 27 per cent (see Appendix, Tables A-2 and A-3).

The Kubitschek Years, 1956-60

After a short period of economic and political turmoil including the suicide of Getúlio Vargas and some abortive attempts to curb inflation, Brazil entered a new era of development. Basic to this new era was the unswerving commitment of the national government to promote industrialization. Initiated by the charismatic new President, Juscelino Kubitschek, the government's growing role in the economy was most clearly manifested in the execution of the Target Plan (*Plano de Metas*).

The Plano de Metas has been referred to as the "most substantial decision consciously taken on behalf of industrialization in the economic history of the country."[27] It essentially involved the coordination of capital

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[27]UN-ECLA, "Fifteen Years," p. 159.

expenditure programs aimed at building vertically integrated industry and the complementary infrastructure. The agricultural sector and social welfare aspects were afforded decidedly low priorities. Attempts to curb inflation during the period were also halfhearted.

Although the national government successfully channelled foreign and domestic capital into those sectors deemed crucial to the Plan (through favorable treatment to foreign investors, import preferences and subsidized loans), the direct participation of the public sector is of greater interest here. The expanding role of the public sector during the 1955 to 1961 period (the Plano de Metas extended from 1957 to 1961) is documented in Table 20, column 4 which shows its expenditure share increasing from 22.2 to 30.2 per cent of the GDP. Moreover, public fixed investment as a percentage of total fixed investment rose from 24.3 to 58.8 per cent between 1955 and 1960.[28] Of the public fixed investment in 1960, 25 per cent was devoted to roads, 29 per cent to PETROBRÁS, 31 per cent to the construction of a new capital in Brasília and 15 per cent to the BNDE.[29]

The available data also reveal the extent to which this capital investment was done by the public and

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[28]Leff, *Economic Policy-Making*, p. 39.

[29]*Ibid.*, p. 40.

semipublic enterprises. In a survey of twenty-one of the most important such firms, it was found that between 1956 and 1959, their fixed capital formation rose from 47 to 98 per cent of the fixed capital formation of the federal government. The same survey also revealed that the federal government was providing more than 20 per cent of the operating receipts of these enterprises in the form of subsidies.[30] This subsidization was especially acute in the transportation and communication sectors where artificially low service rates had produced huge deficits.[31]

At the end of the Plano de Metas most of the original goals had been attained or even surpassed. Electric power, highways, steel and cement production, for example, increased significantly during its period of existence. The economy had also expanded rapidly in the 1957-61 period; the real annual growth rate averaging less than 7.7 per cent in only one year (1959). The economic progress made by Brazil during these years, however, was not without costs.

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[30]Annibal Vilella, "As Emprêsas do Govêrno Federal e sua Importância na Economia Nacional—1956/1960," *Revista Brasileira de Economia*, XVI, No. 1 (1962), 106 and 110.

[31]See Alan Abouchar, "Public Investment Allocation and Pricing Policy for Transportation," in *The Economy of Brazil*, ed. by Howard S. Ellis (Berkeley: University of California Press, 1969).

In carrying out the development plan, the government had resorted to deficit financing which contributed greatly to the extreme inflation of the period. Government deficits as a percentage of the gross national product rose from .8 per cent in 1955 to 2.2 per cent in 1956 to 3.7 per cent in 1961.[32] In 1961 alone, the money supply increased by over 50 per cent (as contrasted to a 38 per cent increase in the previous year).[33] These deficits and resulting increases in the means of payment prompted price inflation which sometimes exceeded a 50 per cent annual rate in the late 1950's and early 1960's (see Appendix, Table A-3).

Although the effects of this hyperinflation on the rate of economic growth are by no means clear, it did produce some distortions.[34] With large amounts of resources flowing from the public to private sector, investment became concentrated in projects with political priorities with little concern for other projects which might have offered

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[32]Eugenio Gudin, "The Chief Characteristics of the Postwar Economic Development of Brazil," in *The Economy of Brazil*, ed. by Howard S. Ellis (Berkeley: University of California Press, 1969), p. 16.

[33]*Ibid.*, p. 15.

[34]For an interpretation of postwar Brazilian industrialization and the role of inflation see: Don Huddle, "Postwar Brazilian Industrialization: Growth Patterns, Inflation, and Sources of Stagnation," in *The Shaping of Modern Brazil*, ed. by Eric N. Baklanoff (Baton Rouge: Louisiana State University Press, 1969), pp. 86-108.

a greater rate of return.[35] As a result, serious bottlenecks arose in agriculture and education, areas with low political priorities.[36] Exports also stagnated, primarily because of an exchange policy which caused exchange devaluations to lag well behind internal price increases.[37]

The marked decentralization of the national government into autarquias and companhias mistas and the widespread earmarking of public revenues also had adverse side effects. The proliferation of public entities outside of the central authority, financed with earmarked or extra-budgetary funds, introduced confusion and duplication while complicating the fulfillment of coherent overall plans. As was mentioned above, unrealistically low rates charged by some public enterprises (principally in transportation) caused them to run large operating deficits; thus necessitating inflationary subsidies from the federal government.

The Hypertrophy of National Government and Economic Stagnation, 1961-64

The early 1960's were years of economic and political chaos in Brazil. From the 6 per cent average

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[35]See Leff, *Economic Policy-Making*, ch. 9.

[36]See Baer, *Industrialization*, esp. ch. 7.

[37]Leff, *Economic Policy-Making*, p. 80.

expansion of the GDP in the previous decade, economic growth fell to an average of just over 3 per cent; with declines in the per capita GDP to be noted during 1963 and 1964 (see Appendix, Table A-2). Furthermore, the rate of inflation took a decidedly upward jump with the price level increasing over fivefold between 1961 and 1964 (see Appendix, Table A-3).

National economic policy during the period, exacerbated by the political situation which produced three different regimes in four years, was at best haphazard.[38] A United Nations study referred to it as "drifting rudderless."[39] Although a tax reform passed in 1962 improved tax revenues, uncontrolled public spending produced deficits in the federal budget which approached 6 per cent of the gross national product by 1964. These deficits, being one of the prime causes of the rampant price inflation which characterized the era, were in part a reflection of the government's attempts to increase its spending in real terms.

The growth of the national government during the 1961-64 period was mainly due to an expansion in the activities of the companhias mistas. Two new steel mills

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[38]For an analysis of the political situation in the early 1960's see: Skidmore, *Politics in Brazil*, pp. 187-302.

[39]UN-ECLA, "Fifteen Years," p. 198.

began operating (COSIPA and USIMINAS) and the national government consolidated and expanded its participation in the production of electric power through the establishment of a public corporation called ELECTROBRÁS. Tax sharing and earmarking also attained new prominence. Benefits to the local governments were augmented (see below) and a fund for railway investment was created on the basis of a 3 per cent earmarking of federal revenues. In 1965, it was estimated that about 30 per cent of the federal government's revenues were earmarked for specific purposes. Additional amounts, perhaps totaling 40 per cent of regular federal revenues, were assigned to special funds on an extra budgetary basis.[40]

By mid-1964 it appeared that the activities of the national government were completely out of control.[41] Inflation was spiraling at an annual rate of over 100 per cent, the economy was stagnating and an inefficient administrative apparatus was dispensing huge sums of money through entities only loosely coordinated by the central authority. The final outcome of this chaotic situation

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[40]Brazil, Ministério de Planejamento, EPEA (Escritório de Pesquisa Econômica Aplicada), *The Brazilian Public Sector in the Postwar Period* (Rio de Janeiro, 1968), p. 6.

[41]The *Plano Trienal* (1963-1965), which stressed banking, fiscal and administrative reforms, was abandoned for political reasons. Campos, "Development Plans," p. 322.

was the Revolution of 1964 which installed a military regime and destroyed democratic government in Brazil for an indefinite period of time.[42]

Attempts at Vertical and Horizontal Fiscal Adjustment

As emphasized in Chapter I, the basic financial problem of all federations is fiscal adjustment, that is, the matching of revenue sources with allocated functions at each administrative level. This problem, moreover, has two fundamental aspects; fiscal adjustment between the several units of government ("vertical") and between regions of unequal wealth ("horizontal"). As the preceding chapters have shown, Brazil had not successfully dealt with either of these two aspects by the end of World War II.

Some limited attempts at tax sharing had been tried in the 1930's and early 1940's to help alleviate the mismatching of revenue sources and responsibilities (especially at the local level), by by 1945 it became obvious that they had been failures. Likewise, sporadic attemps to provide special assistance and/or improve the fiscal positions of state and local governments in the poorer

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[42]Some interesting observations on the role of the military in resolving economic and political conflicts may be found in: Celso Furtado, "Political Obstacles to Economic Growth in Brazil," in *Obstacles to Change in Latin America*, ed. by Claudio Veliz (London: Oxford University Press, 1965), pp. 157-61.

regions of the country had been made almost from the beginning of the republic. The federal programs of regional development in the North and Northeast, although perhaps providing some short-term benefits, were marked by unstable amounts of revenue, political interference and lack of planning from the macroeconomic standpoint. The earmarking provisions of the 1934 Constitution, which could have given some permanence to these programs, were never wholly put into effect due to the short tenure of that document. Fiscal aid to the poorer regions through disproportionate federal spending relative to the federal tax burden in these areas was also utilized as a means to achieve fiscal adjustment before 1946. Although this mechanism probably helped raise the standard of public services in the poorer regions, it was not systemized, was open to political interference and prompted continuing complaints from the richer states, especially São Paulo.

With return of democratic government in 1946, the Brazilians made their first real efforts to regularize the process of administrative and regional fiscal adjustment. The Constitution of 1946, while maintaining the fiscal and administrative supremacy of the national government, sought to revitalize the other levels of government (especially local) by providing them with shares of lucrative federal taxes. In addition, the poorer regions

of the nation were guaranteed a regular flow of resources through the earmarking of federal tax revenues and the creation of regional development agencies. The following sections seek to analyze the workings of these provisions and to assess their attainments.

Vertical Fiscal Adjustment

As was shown in Chapter VI, the resources available to Brazil's municipal system had deteriorated to a very low level by the end of World War II. Wartime price inflation coupled with the rigidity of most local taxes had left the municipalities with considerable less revenue in real terms than they had collected in the immediate prewar years. The writers of the 1946 Constitution, in part reacting to the centralization of the Estado Nôvo and in part realizing the fiscal predicament of local government, concentrated much of their efforts on redressing the imbalance between the finances and responsibilities of the nation's municipal system. These men had grasped that authorizing political autonomy for the municipalities was meaningless without providing the necessary resources needed to carry out their functions.

In providing the municipal system with a greater financial base, two paths were open to the framers of the Constitution: (1) transferring new taxes to the jurisdiction of the municipalities and (2) giving the

municipalities a share of federal and state tax collections. Although both solutions were eventually adopted, neither was completely acceptable. For a number of poorer communities, new taxes would be of limited use because of their low taxable capacities and the lack of efficient collection facilities. The second solution, while minimizing these difficulties, obliged the local governments to be financially dependent on the higher administrative levels.

The final draft of the 1946 Constitution contained a mixture of both potential solutions. As Chapter III pointed out, the tax on industries and professions and the stamp tax were given to the municipalities as well as a 10 per cent share of the federal income tax, a 12 per cent share of the federal "single taxes," 30 per cent of all state taxes collected in a municipality which exceeded the total income of that municipality and 40 per cent of the federal or state collections from any new taxes. The states retained their 48 per cent share of the federal "single taxes."

The transfer of new taxes

Of the two new taxes attained by the municipalities in the 1946 Constitution, only the tax on industries and professions was of real importance as a source of

revenue.[43] There are a number of reasons for its transferral to exclusive local jurisdiction. First of all, one-half of the proceeds of its collection were already being given to the municipalities through the provisions of the 1934 and 1937 Constitutions (the states were to retain the other half). Secondly, some states, such as Pará and Espírito Santo, had already transferred this tax to their respective municipalities. Thirdly, the tax could be efficiently administered by local governments.[44] Finally, it was a good source of income; the 50 per cent of the tax collected by the states in 1947 was equivalent to 35 per cent of total municipal revenues in that year.[45]

In 1948, the year in which the fiscal provisions of the 1946 Constitution first went into effect, the

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[43]The stamp tax never comprised more than a negligible portion of municipal income mainly because of the prevalence of the federal stamp tax. The tax on industries and professions itself was a type of business tax usually assessed simultaneously on a fixed percentage of the rental value of the premises in which the activity was carried out and a fixed amount (or percentage) of the annual gross receipts of the business. Harvard Law School International Program in Taxation, *World Tax Series: Taxation in Brazil*, prepared by H. J. Gumpel and R. Gomes de Sousa (Boston: Little, Brown and Co., 1957), pp. 319- and 322-26.

[44]When collected by the states its rates had to be adjusted to take into account the economic importance of the municipality in which the taxable activity took place. Further more, its similarity to the local license tax involved an unnecessary duplication of collection facilities.

[45]Valentim F. Bouças, "Os Municípios e a Discriminação de Rendas," *Revista de Finanças Públicas*, XII, No. 141 (1952), 5.

municipalities received income from the tax in industries and professions totaling about 737 million cruzeiros, almost double the 378 million cruzeiros received in the previous year.[46] The 1948 collections of the tax represented about 35 per cent of total municipal tax revenues. The tax on industries and professions grew in importance in the ensuing years and by 1964 it was returning to over 100 billion cruzeiros of revenue, or about 50 per cent of total local tax revenues in that year.[47]

Tax Sharing

Far more important than any new taxes given to the municipalities, however, were the tax-sharing schemes. Although the states retained their share of the federal "single taxes," the local governments were undoubtedly the greatest beneficiaries of the programs.

The federal income tax quota

In the original text of the 1946 Constitution, 10 per cent of the federal income tax collections was to be divided equally among the nation's municipalities. Since the income tax represented the second most important source of federal revenue income at the time (after excises),

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[46] FGV-CEF, *Caderno Estatístico*, Table V.

[47] *Ibid.*

these quotas certainly resulted in a large windfall for many local governments. Valentim Bouças, a noted Brazilian financial expert, referred to this tax-sharing scheme as "the most municipalist of the constitutional measures."[48]

Once enacted, the benefits of the income tax quotas were primarily concentrated in the small municipalities of the interior (capital cities were exempted from the share) and acted to redistribute income amassed in the industrial centers of the South and East. Many small municipalities with budgetary receipts of less than 20 thousand cruzeiros were due a federal income tax quota of 250 thousand cruzeiros in 1949. In fact, over 800 municipalities (more than half the total number in 1947) had budgetary receipts totaling less than the income tax share in that year.[49] Since the total share of federal income tax collections to be distributed in 1949 (about 478 million cruzeiros) represented almost 40 per cent of total tax revenues, the potential impact on municipal activity in the poorer regions of the country was undoubtedly tremendous (see Table 23, column 3).[50]

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[48]Bouças, "Os Municípios," p. 6.

[49]*Ibid.*

[50]The municipalities comprising state capitals were excluded from the sharing, essentially because of their superior tax bases. One author mentions that in 1951, the tax receipts of the twenty-four state and territorial capitals exceeded the total tax receipts of the other 1,864 municipalities by about 100 million cruzeiros. Deiral Reinaldo da Silva, "O Município e o Imposta de Renda," *Revista do Serviço Público*, IV, No. 2 (1953), 128.

TABLE 23

Federal Income Tax Sharing with the Municipalities, 1948-64[a] (in cruzeiros)

Year	(1) Total muni. revenue[b] (millions)	(2) Total share of inc. tax[c] (millions)	(3) (2) as % of (1)	(4) Share per muni. (thousands)	(5) Share per muni. at 1953 prices (thousands)
1948	1,036	419	41	117[d]	418[e]
1949	1,279	478	37	250	417
1950	1,648	558	34	257	384
1951	1,814	810	45	299	268
1952	1,980	999	50	434	499
1953	2,370	1,164	49	524	524
1954	2,760	1,534	56	548	431
1955	3,572	1,926	54	655	443
1956	4,486	2,452	55	649	367
1957	5,860	2,702	46	802	397
1958	6,860	2,477	41	1,004	438
1959	8,200	3,005	37	1,039	329
1960	24,595	3,185	13	1,170	370
1961	34,206	4,638	13	1,664	298
1962	50,570	27,335	54	7,691	907
1963	86,865	36,449	42	8,607	584
1964	187,067	72,362	39	17,589	626

Source: 1948-1959 data in column (1) from "States and Municipalities—Their Share of the Union's Tax Revenue," *Conjuntura Econômica*, international ed., VII, No. 12 (1960), 49; 1960-1964 data from IBGE, *Anuário Estatístico* (1961-1965). 1948-1961 data in columns (3) and (4) from *RFP (Revista de Financas Públicas)*, XX, No. 215 (1960), 2 and *RFP*, XXI, No. 218 (1969), 2; 1962-1964 figures computed by the author based on data from IBGE, *Anuário Estatístico* (1963-1965).

[a]Amounts due, not necessarily paid.

[b]Totals for 1948-1959 exclude state capitals.

[c]Totals for 1948-1961 represent a 10 per cent share; 1962-1964 represent a 15 per cent share.

[d]5 per cent share.

[e]Considered as 10 per cent share.

In the decade which followed the enactment of this tax-sharing scheme, the income tax quota due the municipal system naturally grew in absolute terms, from the 420 million cruzeiros in 1948 to 3.2 billion cruzeiros in 1958 (see Table 23, column 2). The share per municipality also rose appreciably during the same period, but at a much slower rate, increasing from the 250 thousand cruzeiros in 1949 to over 1 million cruzeiros in 1959 (see Table 23, column 4). In relative terms, the total share of the federal income tax varied between 34 per cent (in 1950) and 56 per cent (in 1954) of total local revenues from taxes and fees (see Table 23, column 3). Due to such factors as price inflation and the proliferation of municipalities, however, the sharing of federal income taxes never had the intended impact on local government. By 1959, each municipality was due an income tax quota which was about 20 per cent smaller in real terms than the quota in 1949 (see Table 23, column 5). These figures, moreover, conceal the fact that in many years the federal government was tardy in making payments and in some years made partial or no payments at all (these negative aspects of the tax-sharing schemes are discussed more fully below).

In recognition of these problems, Constitutional Amendment 5, which was passed in 1961, raised the share to 15 per cent, regularized payment periods and included

state capitals in the distribution. Since municipal revenues from all taxes totaled 34.2 billion cruzeiros in that year and federal income tax revenues 83.7 billion cruzeiros, the new 15 per cent share would have meant a 40 per cent addition to local tax revenues. For essentially the same reasons mentioned above, however, the flow of income actually reaching the municipalities never attained such large proportions.

The federal excise quota

Through Amendment 5, the municipal system was also awarded a 10 per cent share of the federal excise tax. An additional feature was that the share of the federal excise tax was to be given to the municipalities with "no strings attached" (50 per cent of the income tax quota was to be applied to "benefits of a rural nature"). Since excises were by far the largest source of federal tax revenue in 1961 (comprising over 40 per cent of the total), this amendment ostensibly demonstrated an increasing federal interest in strengthening local government. Some have even referred to 1961 as the "high mark of municipal independence."[51]

The potential fiscal impact of the federal income and excise tax shares cannot be overemphasized. Had they

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[51]Sherwood, *Grass Roots*, p. 41.

been in 1961, they would have augmented municipal tax revenues by over 80 per cent.[52] Once again, however, mitigating circumstances prevented this from occurring.

The Federal "Single Tax" Quota

The sharing of the federal "single tax" on fuels and lubricants dates from a 1940 amendment to the 1937 Constitution (see Chapter III), although the 1946 Constitution broadened its base to include electric energy and minerals. The tax on fuels, levied to finance the federal highway program established in 1946, was supposed to be divided among the states and municipalities on a 48 per cent-12 per cent basis. Each state and municipality was to receive a share of the tax in proportion to their area, population, consumption and production, with the proceeds to be primarily earmarked for highway construction and maintenance. In addition, Decree no. 38,963 of April 3, 1956, entitled the Federal District and the territories to 30 per cent of the federally collected exchange premiums on the importation of petroleum and petroleum by-products, to be used for the paving of highways.

The tax on the consumption of electric energy was collected by the federal government and distributed by the BNDE "according to the urgency and requirements of the

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[52]FGV-CEF, *Caderno Estatistico*, Table V.

various regions of the country."[53] The states were to share in 50 per cent of the proceeds, the municipalities 10 per cent and the Federal Electrification Fund the remaining 40 per cent. The tax on minerals, however, as of 1960 had been collected by the states in accordance with the Mining Code, but they were to be abolished and distributed by the federal government on a basis similar to that of the fuels tax.[54]

The states' share.--In the decade following the enactment of the fiscal provisions of the 1946 Constitution, the share of the federally collected fuels tax became an important source of state revenue. Federal revenues from this tax rose rapidly between 1948 and 1959, from 1.1 billion cruzeiros in the former year to almost 23.6 billion cruzeiros in the latter. The quota due the states grew from 556 million cruzeiros to 8.4 billion cruzeiros in the same period.[55] Both in 1948 and 1959, this quota represented an amount equal to about 7 per cent of total state

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[53]"States and Municipalities--Their Share of the Union's Tax Revenue," *Conjuntura Econômica*, international ed.. VII, No. 12 (1960), 47.

[54]The first evidence of federal collections of a mineral tax appear in the 1965 budget. Some states, such as São Paulo and Minas Gerais, however, did share their proceeds from the mineral tax with their respective municipalities. Diogo Lordello de Mello, "O Problema das Finanças Municipais no Brasil," *Revista Brasileiro dos Municípios*, IX, No. 35/36 (1956), 211.

[55]"States and Municipalities," p. 47.

tax revenues.[56] This latter percentage would have been much higher, had the federal government not earmarked 15 per cent of the proceeds from the tax for PETROBRÁS (in 1953) and an additional 15 per cent for the National Highways Fund (in 1957). In 1959, the 25 per cent of the tax lost to the states through this earmarking amounted to 3.8 billion cruzeiros.[57]

By 1964, the states' share of the fuel tax had risen to 103.7 billion curzeiros or about 6.5 per cent of total state revenues.[58] Much of this gain in absolute terms, however, was the result of inflation since the general price level rose almost ninefold between these two dates.

The "single tax" on electric power, although a much smaller addition to state income than the tax on fuels, began to be collected in 1955. By 1964, the combined state and local shares from this tax reached 19.6 billion cruzieros, an amount substantially less than either the state share of the fuel tax or the municipal share of the income tax.[59]

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[56] FGV-CEF, *Caderno Estatístico*, Table V.

[57] "States and Municipalities," p. 47.

[58] FGV-CEF, *O Setor Público Federal na Economia Brasileira*, Vol. III: *A Vinculação de Receitas da União* (Rio de Janeiro, 1966), p. 208.

[59] "States and Municipalities," p. 47.

The municipalities' share.—The municipalities also received a share of the "single taxes," but only 12 per cent. As was the case with the states, however, only the tax on fuels assumed any real importance as an addition to local revenue. Distributed by the National Department of Roads and Highways through various intermediaries, the municipal share of the fuels tax was intended for use in road and highway construction and maintenance. The relatively small quotas awarded to the local governments were unfortunate, though, since about three-fourths of all Brazilian roads are municipal.[60]

Nevertheless, the share of the "single tax" on fuels to be distributed to the municipalities rose from 137 million cruzeiros in 1948 to 25 billion cruzeiros in 1964.[61] This latter figure was equal to about one-third of the share of the federal income taxes due to the local governments and about 13 per cent of their total income from taxes and fees.

Article 20

A final tax-sharing device in the 1946 Constitution concerned transfers of revenue from the states to the municipalities. According to Article 20 of the document,

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[60] *Ibid.*, p. 50.

[61] FGV-CEF, *A Vinculação de Receitas*, p. 208.

the states were to return 30 per cent of the excess of their tax receipts in a particular municipality over the total income ("of any nature") of that municipality. The capitals of states were to be excluded from this quota because it was felt that they had greater fiscal capacities and usually received a large share of the benefits of economic progress in the other cities and regions of the state. In addition, it was hoped that the exclusion of state capitals from the share would tend to promote "urban decentralization."[62]

The potential problems of implementing Article 20 were recognized soon after it went into effect. First of all, the 30 per cent share was thought by some to be insufficient to prevent state encroachment on the local tax bases since the states would always retain the other 70 per cent. Secondly, the term "local receipts of any nature" was not clear in meaning; the legal interpretation of this phrase would be an important determinant of the amounts actually due to the municipalities. Finally, the states, by their authority to supervise Article 20, became interested parties.[63] In an apparent effort to smooth the

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[62]Carlos Alberto A. de C. Pinto, "O Artigo 20 da Constituição Federal e as Capitais," *Revista de Administração Municipal*, XII, No. 72 (1965), 329-30.

[63]Bouças, "Os Municípios," p. 7.

implementation of this provision, the states were given a ten-year grace period. Through 1965, though, eighteen states and all the territories had not paid any of the money due their respective municipalities through Article 20.[64]

Tax Sharing: An Assessment

As the preceding sections have implied, the postwar Brazilian experience with tax sharing to attain vertical fiscal adjustment was not altogether successful. As Table 22 illustrates, the distribution of federal taxes with the states and municipalities would have substantially altered the relative distribution of tax revenues had the constitutional schemes been duly implemented. The negative aspects which accompanied the tax-sharing programs, however, greatly diminished their intended positive aspects. The following are the most important of these negative aspects.

Nonpayment of shares

Perhaps the greatest failure of the various tax-sharing schemes was the flagrant nonpayment of the quotas. One author states that between 1948 and 1953, 1952 was the only year in which the municipalities actually received their share from the federal income tax. By 1953, over

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[64]Wolfgran Junqueira Ferreira, "Aspectos Negativos da Reforma Tributária," *Revista de Administração Municipal*, XII, No. 73 (1965), 423.

TABLE 24

Percentage Distribution of Tax Revenues Among the Federal, State and Municipal Governments Before and After Tax Sharing, 1948-59[a]

Period		Federal (% of total tax revenue)	State (% of total tax revenue)	Municipal (% of total tax revenue)
1948-51	Before sharing	52	39	9
	After sharing	48	41	11
1953-55	Before sharing	51	41	8
	After sharing	47	43	10
1956-59	Before sharing	53	40	7
	After sharing	48	43	9

[a]Excluding the provisions of Article 20.

Source: Adapted from "States and Municipalities—Their Share of the Union's Tax Revenue," *Conjuntura Econômica*, international ed., VII, No. 12 (1960), 46.

275 million cruzeiros due to the local governments had not been paid.[65] The record for the ensuing years was no better. In the 1955-61 period, payments were continually late—often in years different from when they were due. Constitutional Amendment 5, which sought to regularize the payment of the tax shares, apparently did little to improve the situation. In 1962, the income tax share was paid late and the excise tax share was not paid at all. In 1963, the municipalities again received their share of the income tax late, and 25 per cent of the excise tax share which had been due in the preceding year. Neither the income or excise tax quotas were distributed in 1964.[66]

The experience with Article 20 has shown that the states were also unable or unwilling to share tax receipts with local governments. As mentioned previously, only a few states had actually made payments under this constitutional provision by 1965. Of the twenty-two Brazilian states, only three (Rio Grande do Sul, São Paulo and Santa Catarina) regularly paid them. Among local governments in regions other than the South, the percentage of nonrecipients varied between 82 and 96 per cent.[67] Frank P. Sherwood has

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[65]D. R. da Silva, "Imposto de Renda," p. 126.

[66]Ferreira, "Aspectos Negativos," p. 422.

[67]Sherwood, *Grass Roots*, p. 126.

hypothesized that the concentration of recipient municipalities in the wealthier southern region stems from the tendency of higher levels of government to make larger transfers to those lower levels of government already providing superior public service outputs.[68]

In contrast to the nonpayment of the quotas from the income and excise taxes and Article 20, the shares of the federal "single taxes" were apparently paid promptly and in full. A 1959 study showed that over 90 per cent of the nation's local governments had actually received their quotas.[69] Although complete information is not available, it is probable that the states also received their shares of the "single taxes." Since the distribution of the "single taxes" was under closer supervision and the quotas were for earmarked purposes, "money may have been forthcoming because there was a fair anticipation of the production of service outputs."[70]

Municipal proliferation

Since the quotas from the income tax were to be shared equally among the local governments, there was a natural tendency for municipalities to subdivide. In reference to the income tax share, it has been stated that the

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[68] *Ibid.*, p. 127.

[69] *Ibid.*

[70] *Ibid.*

"criterion adopted for its distribution has undoubtedly been one of the greatest incentives for the exaggerated proliferation of municipalities in Brazil."[71] The extent of this numerical growth in municipalities is shown in Table 25.

Although the number of local governments increased from 1,574 in 1939 to 4,114 in 1964, the most accelerated period of growth occurred between 1960 and 1963 when the total increased by almost 50 per cent. Moreover, this growth appeared to be regionally concentrated in the North and Northeast. In 1962 alone, the state of Amazonas increased the number of its municipalities from 84 to 296, the territory of Acre from 7 to 25, the state of Ceará from 152 to 302 and the state of Rio Grande do Norte from 113 to 152. In contrast, the southern and eastern states of São Paulo, Minas Gerais and Paraná showed small gains (or a net decline in the case of São Paulo) during the same year. One author suggests that the unbalanced regional expansion of municipalities in the more depressed and less populous states came about because a "few expected to share in the resources that would be forthcoming."[72]

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[71]"States and Municipalities," p. 49.

[72]Sherwood, *Grass Roots*, p. 65.

TABLE 25

The Number of Municipal Governments in Selected Years, 1939-64

Year	Number	Year	Number
1939	1,574	1960	2,855
1945	1,669	1961	3,062
1948	1,703	1962	3,554
1953	1,956	1963	4,235
1957	2,468	1964	4,114

Source: Adapted from Brazil, IBGE, *Anuário Estatístico* (1949-1965).

Regardless of the reasons for the municipal proliferation, however, the impact of this phenomenon on the per municipality share of the income tax was substantial. Had the number of local governments remained constant between 1948 and 1961, the per municipality share would have been almost double the amount it actually was in the latter year. As can be noted from Table 23, the coming to power of a military government resulted in a shrinkage of the number of local governments in 1964.

Effects on local tax efforts

One problem inherent to intergovernmental transfers is that they may tend to dampen the incentive of the recipient government to make optimum use of its own revenue sources. This is especially true when the criterion for distributing the transfers makes no allowance for the degree

of tax effort being made by the recipient unit. There is some evidence to suggest that this was an actual problem in Brazil during the postwar years.

In Santa Catarina and Rio Grande do Sul, states noted for paying their obligations under Article 20, it is quite common for a municipality to receive over 50 per cent of its income from transfer payments. It has been documented, however, that the productivity of the local tax systems in these states is low when compared to local governments in poorer states. A 1959 study of the nation's municipal system lends further support to the contention that units of government receiving relatively large amounts of transfers are less apt to make full use of their own revenue sources. In that study, it was found that the smaller municipalities (in terms of population) were generally more dependent on shared revenues than the larger municipalities. The smaller localities, however, were less apt to have a tax code, an up-to-date tax map and frequently utilized gross receipts as the basis for the tax on industries and professions.[73]

Horizontal Fiscal Adjustment

The attempts to secure an equilibrium of resources and responsibilities among the administrative units of the

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[73] *Ibid.*, pp. 128-29.

nation were accompanied by attempts to attain a greater regional equilibrium. Federal initiatives related to the latter goal were basically of two types: those intended for developmental or special assistance purposes and those intended to compensate for the low service standards of the state and local governments in the poorer regions.[74] To these ends the Constitution of 1946 provided for the earmarking of tax revenues for the benefit of the Northeast, the Amazon River Valley and the São Francisco River Valley. Although these funds were primarily intended for developmental or special assistance purposes, they probably did serve to raise the relative level of public services in these regions. In addition, the federal government apparently continued to spend more than it collected in taxes in at least the Northeast region, a phenomenon previously documented in other periods of Brazilian history.

The problem summarized

The fact that extreme disparities of income and wealth existed in Brazil in the postwar years is unquestionable. In a twenty-four country study published in 1965, for

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[74]Both ends, however, were related, i.e., the developmental programs would hopefully increase the tax bases of the regional governments and the compensatory spending might tend to redistribute income from the richer to the poorer regions.

example, Brazil ranked first in terms of regional income inequality.[75] Per capita income figures for 1960 indicate that of the nine states comprising the Northeast, all had totals less than 60 per cent of the national average. One state, Piauí, had a per capita income which was 29 per cent of the national average. The states of Guanabara and São Paulo, in contrast, had per capita incomes equal to 297 and 178 per cent, respectively, of the national average.[76]

These large differences between regional incomes are reflected in the extreme national variations in per capita revenues and expenditures of the state and local governments. As Table 26 illustrates, the states and municipalities in the poorer northern and northeastern regions collected and spent considerably less than the analagous governmental units in the more prosperous South. The differences in per capita revenues and expenditures between Piauí and São Paulo are especially striking. Whereas the local governments of the latter state spent about ten times the amount per person as in the former; the state government of São Paulo spent almost twenty-five times the amount per

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[75]Jeffery G. Williamson, "Regional Inequality and the Process of National Development: A Description of the Patterns," *Economic Development and Cultural Change*, XII, No. 4, Part II (1965), 12.

[76]The national average per capita gross domestic product in 1960 was equivalent to about U. S. $200 at the free rate of exchange. "Brazil's National Accounts," p. 37.

TABLE 26

Per Capita Revenues and Expenditures of State and Municipal Governments in Six Selected States, 1960 (in cruzeiros)[a]

Geographical Area	State		Municipal	
	Rev.	Exp.	Rev.	Exp.
Amazonas (North)	1,588	1,346	295	315
Pará (North)	999	1,112	463	443
Bahia (Northeast)	1,026	1,142	403	397
Piauí (Northeast)	323	383	190	169
São Paulo (South)	7,318	7,318	1,596	1,677
Paraná (South)	2,499	3,664	901	917
BRAZIL	2,966	3,123	634	620

[a]Worth U. S. $.05 in 1960 at the free rate of exchange.

Source: Adapted from Brazil, IBGE, *Anuário Estatístico—1961*, pp. 433-35 and Brazil, IBGE, *Anuário Estatístico—1962*, pp. 27, 349-50.

person as did the state government of Piauí. One would assume that the differentials in the levels of public services between these two states were about as great.

The federal programs

As was noted above, the postwar federal programs to aid the poorer regions of the country had their bases in the earmarking provisions of the 1946 Constitution (see Chapter III). According to these provisions, the Northeast was to receive 3 per cent of federal tax revenues for combatting the effects of the drought and the São Francisco and Amazon River Valleys were to receive 1 per cent and 3 per cent, respectively, for developmental purposes. In addition, the states, territories and municipalities within the affected regions were supposed to complement the federal programs through the earmarking of 3 per cent of their respective tax revenues.

The North.—Federal activity in Brazil's North was by no means a postwar phenomenon. Between the initial collapse of the rubber industry in 1912 and its second collapse after World War II, many attempts were made by the government to revive the regional economy and improve the health and well-being of its inhabitants.[77]

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[77]See Andrade, *História Administrativa*, II, 7-67.

Previously presented data have shown that the region generally received a net inflow of federal expenditures (see Tables 10 and 19). Lack of coordination between federal programs in the area and a general stagnation of the regional economy, however, prompted the inclusion of the tax earmarking scheme in the 1946 Constitution.

The first implementation of this constitutional provision came in 1953, seven years after the promulgation of the document.[78] In the years which followed a substantial amount of federal funds flowed into the region but they were apparently used inefficiently and were relatively meager in relation to the enormous geographical limits of the North (comprising 42 per cent of Brazil's total land area). Problems similar to those encountered in federal tax sharing also arose.

Of the 70.7 billion cruzeiros due the program between 1954 and 1964, only 45.2 billion cruzeiros were actually received.[79] Furthermore, approximately 25 per cent of these proceeds went to entities not directly connected with the overall planning agency (*Superintendência do Plano de Valorização Econômica da Amazônia SPVEA*). The prescribed contributions of the states, territories and municipalities

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[78]Law no. 1,806 of January 6, 1953.

[79]Brazil, SPVEA (Superintendência do Plano de Valorização da Amazônia), *Relatório*, (Belem, n. d.), p. 31.

of the region were only about 30 per cent of the amounts actually due.[80] Inflation also took its toll of appropriations to the North. Since the 3 per cent portion of federal tax revenues earmarked for the region was based on the preceding year's collections, the quota was greatly reduced in real value by the time it reached the recipients.

In contrast to earlier periods of Brazilian history, overall federal spending policies in the North became increasingly unfavorable to the region. In the 1957-62 period, federal expenditures in the North declined from 3.4 per cent to 1.8 per cent of the total, with the sum in 1962 being smaller in real terms than the sum in 1957. Although federal transfers to the region almost doubled in constant prices during that period (principally because of the municipal proliferation in the area) all other types of federal spending underwent declines.[81]

The failure of the federal program to develop Brazil's North is partially reflected in the regional income data. While the per capita incomes of the states of Amazonas and Pará were 76 and 61 per cent, respectively of the national average in 1956, they had fallen to 68 and 56 per

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[80] *Ibid.*, p. 32.

[81] CNI (Confderação Nacional da Indústria), *A Indústria Brasileira e a Amazônia* (Rio de Janeiro: Edição do Serviço Social da Indústria, 1969), p. 175.

cent by 1960.[82] This relative economic decline of the North continued into the 1960's as the region's share of the domestic income declined from 2.2 to 1.9 per cent between 1960 and 1964.[83]

The Northeast.—As was the case with the North, special efforts to aid the Northeast date from the early years of the First Republic. Foremost among these initial efforts were the attempts to combat the effects of the droughts that have periodically plagued the region. Unfortunately, however, federal funds available to the agency in charge of this function, since 1945 called the National Department of Works Against the Drought (*Departamento Nacional de Obras Contra as Sêcas* or DNOCS), varied with the frequency and severity of the droughts.[84] Overall federal spending before World War II generally favored the Northeast (see Tables 10 and 19), but there was little evidence of long-term planning except for the two resource development agencies in the area, the São Francisco River Valley Commission (CVSF) and the São Francisco Hydroelectric Company (CHESF).

In the 1950's and early 1960's, however, several new federal agencies were established which greatly increased

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[82]Baer, *Industrialization*, p. 171.

[83]"Brazil's National Accounts," pp. 65 and 68.

[84]See Robock, *Brazil's Developing Northeast*, pp. 75-77.

the flow of resources into the Northeast. The Bank of the Northeast (*Banco do Nordeste do Brasil* or BNB), funded by an earmarking of .8 per cent of federal tax revenues, was created in 1952 and began operations in the following year. After a slow start, the credit activities of the BNB expanded rapidly and its staff of technicians carried out many valuable research projects. By 1961, the BNB loans outstanding equalled the total for the entire private banking system of the region.[85]

Probably of greater importance to the economy of the Northeast, however, was the establishment of an autonomous development agency in 1959.[86] The Superintendency for the Development of the Northeast (*Superintendencia do Desenvolvimento do Nordeste* or SUDENE) was empowered to control and supervise the other main federal activities in the area (DNOCS, CVSF and BNB) and in addition was authorized a 2 per cent earmarked share of federal tax revenues. With the creation of SUDENE, the federal government was obliged to earmark almost 10 per cent of its tax revenues for the Northeast. Bilateral aid from the United States and other countries plus aid from multinational organizations such as the United Nations also supplemented the agency's funds.[87]

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[85] *Ibid.*, p. 99.

[86] Law no. 3,692 of December 15, 1959.

[87] Robock, *Brazil's Developing Northeast*, *passim*.

To induce industrial expansion in the area, firms were given preferential treatment in obtaining foreign exchange, were exempt from import duties on certain goods and were allowed a reduction in their income tax liabilities.[88] By 1964, over two hundred industrial firms enjoyed these privileges, the majority being engaged in food processing, textiles and chemicals.[89]

In 1960, SUDENE's first year of operation, overall federal expenditures in the Northeast were substantial, totaling 27.1 billion cruzeiros. Considered in conjunction with federal revenues in the region of 11.7 billion cruzeiros, this meant a net inflow of federal funds of more than 15 billion cruzeiros.[90] During the 1948 to 1956 period there was also a net inflow of federal resources into the area, but they only served to counterbalance the net outflow of private assets from the region stemming from federal policies to promote industrialization in the South.[91] Furthermore,

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[88]See Albert O. Hirschman, "Desenvolvimento Industrial no Nordeste Brasileiro e o Mechanismo de Crédito Fiscal de Artigo 34/18," *Revista Brasileira de Economia,* XXI, No. 4 (1967), 5-34.

[89]FGV, Banco Interamericano de Desenvolvimento—EIAP, *A SUDENE e a Industrialização do Nordeste,* monograph no. 13 (Rio de Janeiro, 1968), p. 29.

[90]Margaret H. Costa, "Finanças Públicas do Nordeste," in *Recursos e Necessidades do Nordeste*, ed. by the Banco do Nordeste do Brasil, S/A (n.p., 1968).

[91]Brazil, Conselho de Desenvolvimento do Nordeste, *A Policy for the Economic Development of the Northeast* (Recife, 1959), p. 2.

federal expenditures in the earlier period amounted to little more than a subsidization of consumption, having a limited impact on long-term development and job creation goals.[92]

The intention of SUDENE was to reverse the flow of capital from the Northeast and to direct federal expenditures to more productive ends. To accomplish the former goal, SUDENE initiated the industrial incentives mentioned above. To accomplish the latter, the agency devoted a large proportion of its resources to the construction of infrastructure (75.5 per cent and 68.3 per cent, respectively, in its first two investment programs).[93] The results of these two strategies have been striking. The value of industrial investments approved for benefits, for example, rose from 7.5 billion cruzeiros in 1960 to 133.4 billion cruzeiros in 1964 (about threefold in real terms).[94] Between 1959 and 1965, the mileage of paved roads in the region increased by 125 per cent and electric power capacity increased by 81 per cent.[95]

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[92] *Ibid.*, pp. 41-45.

[93] CNI, *II Encontro de Investidores no Nordeste* (Rio de Janeiro: Edição do Serviço Social da Indústria, 1968), p. 48.

[94] FGV, Banco Interamericano de Desenvolvimento—EIAP, *Industrialização do Nordeste*, p. 30.

[95] CNI, *II Encontro*, pp. 49-50.

There are indications that the efforts of SUDENE have also helped to raise the service standards of the states and municipalities in the region. The following recent programs make this contention clear. Guaranteed by the proceeds of their shares of the federal tax, sixty-one municipalities were receiving loans in 1965 for financing local electrification. On the basis of a 12.9 million dollar loan to the BNB from the Interamerican Development Bank, five major northeastern cities were receiving funds for the construction of water and sewerage systems. At the same time, state governments were receiving funds for similar projects, including the construction of 8,500 units of public housing in Pernambuco.[96] In addition, both state and local governments were receiving aid for building classrooms and teacher training.[97]

The success of governmental activity in the Northeast, in contrast to its apparent failure in the North, is also partially revealed in regional income data. While the position of the northern states worsened in this respect in the latter part of the 1950's, the Northeast (except for the drought year of 1958) expanded more rapidly than any

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[96]CNI, *I Encontro de Investidores no Nordeste* (Rio de Janeiro: Edição do Serviço Social da Indústria, 1967) pp. 97-98.

[97]Robock, *Brazil's Developing Northeast*, p. 171.

of Brazil's other regions during the same period.[98] Furthermore, between 1960 and 1964, the Northeast increased its share in the domestic income from 10 to 11 per cent.[99]

SUDENE and SPVEA compared

The experience of SUDENE was more favorable than that of SPVEA for several reasons. First of all, the former agency enjoyed more generous financing, i.e., almost 10 per cent of the federal tax revenues (versus 3 per cent for SPVEA) plus significant bilateral and multilateral foreign aid. In addition, the initial level of infrastructure was already higher in the Northeast and the geographical area over which the funds were to be distributed was much smaller. Thirdly, the stimulants to private investment offered in the Northeast were not applicable to the North until 1963. Finally, in contrast to SUDENE, SPVEA was unable to integrate federal funds flowing into the area and was forced to operate with personnel which were decidedly inferior in quantity and quality.[100]

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[98] *Ibid.*, p. 46

[99] "Brazil's National Accounts," pp. 65 and 69.

[100] FGV, Banco Interamericano de Desenvolvimento—EIAP, *Desenvolvimento da Amazônia—SUDAM*, monograph no. 10 (Rio de Janeiro, 1967), pp. 10-12.

Summary

The nature of Brazilian fiscal federalism in the postwar years was highly influenced by the decision of the national government to actively promote economic development through industrialization. As a result, the expenditures and revenues of the public sector rose rapidly in absolute terms and relative to the national product. Moreover, most of this rapid increase in public activity can be attributed to the national government. Largely at the expense of the private sector, this level of authority channelled huge sums of money into various investment projects through indirect stimulants and direct participation.

The growth of the national government as an entrepreneur was an especially important characteristic of the period. Public initiatives in steel and iron production, transportation, communications and electric power did much to complement the accelerated private industrial activity. Implemented through autarquias and companhias mistas financed with earmarked federal revenues, special extra-budgetary funds or their own revenues, the entrepreneurial functions of the national government were responsible for much of the decentralization which took place at that level of authority.

The municipalities and poorer regions of the nation also received special consideration. The former were provided with shares of the lucrative federal income and excise taxes and were also entitled to quotas from state tax collections. The latter were given constitutionally earmarked shares of total federal revenues and were allowed to offer tax concessions in order to attract industrial firms. In addition, a regional development agency was established to coordinate public activity in the Northeast, Brazil's chronically depressed region.

The hypertrophy of the national government in the postwar years did have its adverse effects. Its growth was manifested within an inefficient administrative apparatus distributed among a large number of public entities only loosely coordinated and controlled by the central authority. Of these decentralized arms of the national government (especially in transportation and communications) continually ran large deficits prompting frequent bailing out operations by the federal government. In addition, the inability of tax receipts to keep pace with expenditures and the use of the printing press to cover the resulting deficits precipitated spiraling price inflation. By 1964, the activities of the national government were clearly out of control and the economy was stagnating.

The excesses of the national government also had their effects on the states and municipalities. Tax-share quotas due to the latter units deteriorated in value due to the inflation and in many years the national government "forgot" to pay them at all. Furthermore, the exclusive taxes of the local governments, generally being price-inelastic types, became increasingly less productive. The states, possessing the price-elastic sales taxes, were better able to shield themselves from inflation, but like the municipalities were contrained in their activities by the disintegration of the internal credit market.

Finally, there are indications that the substantial economic and financial power wielded by the national government had negative effects on the political autonomy of the states and municipalities. Although the Constitution of 1946 guaranteed the *de jure* political autonomy of these latter administrative units, their dependence on the central authority for loans, tax shares and other benefits did much to impair their *de facto* autonomy. In some cases, the main criterion for receiving financial support from the national government seems to have been political allegiance.[101]

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[100]For examples see: M. Seabra Fagundes, "O poder econômico da União e as suas repercussões sobre a autonomia política dos Estados," *Revista Brasileira de Estudos Políticos* III, No. 5 (1959), 30-55.

CHAPTER VIII

CONCLUSION

It is the purpose of this final chapter to summarize and evaluate the most important trends in Brazilian fiscal federalism since 1889. Although the preceding chapters have been almost entirely concerned with the Brazilian experience, the present chapter seeks to compare and contrast this experience with those of other federations, both mature and emergent. The reader will no doubt appreciate that the evolution of Brazilian federalism, while being unique in many ways, has exhibited tendencies common to virtually all federations during their stages of development.

Historical Trends

The previous chapters have clearly revealed that Brazilian fiscal federalism has not been a static concept. Between 1889 and 1964, the country underwent widespread social, economic and political changes which necessitated adaptations in the various intergovernmental relationships. Although these adaptations were often purely political in nature, they ultimately led to changes in the nature of the country's public finances.

During the first forty years of federalism in Brazil, government in general played a relatively minor economic and social role. The country was controlled by a rural oligarchy which viewed the government as a vehicle for furthering its ends and maintaining the status quo. The structure of the federal system during this period fostered the attainment of this goal. Since the federal constitution reserved voting privileges to the literate, up to 80 per cent of the country's population was effectively disenfranchised. The regional basis of the national congress also tended to entrench the power of the rural oligarchy.[1] Moreover, the power of the presidential office was passed between the economically dominant states of Minas Gerais and São Paulo. State and local government was generally the fiefdom of traditional upper class families and/or local élite.

Even though public activity was minimal during the First Republic, the constitutional division of revenue sources between the national government and the states was a continuing issue. The original distribution of revenue sources, generally thought to have favored the states, was often disturbed by federal encroachments into the states' sphere of taxation. Potential conflict, however, was mitigated by the laissez-faire attitude of the era and

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[1]Furtado, "Political Obstacles," p. 154.

the free use of foreign credit for financing activities at all levels of government.[2]

With the onset of the Great Depression in 1929, laissez faire was conclusively abandoned in Brazil. Declines in economic activity adversely affected the traditional sources of state revenue (both internal and external) and at the same time created innumerable problems calling for public attention. Reaction to this crisis was manifested in a growing importance of the national government. Being in a superior position to finance activities through external borrowing and money creation, the federal government rapidly assumed the responsibility for performing functions previously reserved to the states (especially commodity support) and functions never before assumed by any level of Brazilian government (especially in the area of social welfare).

This transformation from laissez faire to the "interventionist state" was greatly aided by the change in political philosophy which characterized the depression years. The "popularly elected" governments of the First Republic were replaced by a dictatorship which sought to extend the influence of the state in many functional areas. The two constitutions promulgated during the 1930's

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[2]What little public activity which did take place during this era, moreover, was primarily directed toward benefiting the rural oligarchy.

reflected this attitude, especially in their provisions pertaining to economic and social matters. Although the attention paid to social questions was no doubt tainted with demagoguery, it did represent an abrupt change from previous regimes.

The centralized growth of the public sector brought about by the depression was further enhanced by World War II. For purposes of national defense, the federal government increased its direct and indirect controls over the economy. A minimum wage was established and the federal government engaged in limited economic planning as well as direct participation in the metalurgical and transportation industries through the creation of several public enterprises. The war years were also characterized by a growing use of the income tax by the federal government, price inflation and a deterioration of local finances.

Throughout most of the 1930-45 period, federalism in Brazil was purely fictional. The attempts to undermine the power of the rural oligarchy, which had been well served by the "dualist federalism" of the First Republic, were accompanied by a destruction of federalism itself. By increasing the power of the national government at the expense of the states and municipalities, Getúlio Vargas sought to cultivate a political base within the growing urban labor force through various social welfare programs while at the

same time taking over the performance of activities favoring the export economy. Assuming these latter responsibilities (coffee support, for example) not only placated regional economic interests but also reduced the power of their leaders. A continuation of the pre-1930 federal system would have greatly complicated the attainment of these goals.

After World War II, a short-lived return to economic liberalism was followed by a rapid growth of the public sector. Dominated by the national government, public activity in this period was primarily concentrated on the promotion of national economic development. Various mechanisms were instituted to encourage industrialization in the private sector and the national government directly participated in the production of iron and steel, electric energy, petroleum, transportation and communications. Intergovernmental fiscal cooperation was increased during this period through tax-sharing schemes and attention was given to the problem of regional income disparities.

The return to federalism in the postwar years probably did little to foster the goal of national economic development. In fact, it can be argued that federalism interfered with its attainment. The Constitution of 1946 once again returned the legislative branch of government to the traditional ruling class and they continued to frustrate the performance of public activities aimed at

improving the "general welfare." National executives desiring the approval of development projects were continually faced with the reluctance of Congress to approve any new revenue sources which would tend to distribute the fiscal burden more equitably. Furthermore, all appointments to important public positions were subject to the approval of the traditional ruling class which naturally favored persons sympathetic to their interests. In referring to this period, Celso Furtado states that the Brazilian "central government can be looked upon as an apparatus for collecting taxes from the towns and more advanced areas of the country, the revenue from which is used to maintain an administrative machine controlled by and designed to serve the interests of the old ruling class."[3]

Since it would appear that Brazil was constrained in its economic development by "political bottlenecks," one may well question the theoretical compatibility of federalism to a development drive based on widespread government intervention. There seems to be a basic contradiction between the two concepts as revealed by the Brazilian experience. Since a national development program based on public activity almost inevitably entails a growing role for the central authority, there is an initial bias against maintaining the

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[3]Furtado, "Political Obstacles," p. 159.

fiscal and political autonomy of state and local governments.[4] If these lower administrative units, on the other hand, actively engage in promoting their own regional interests, the program of national development may be impaired.[5] One can only speculate, however, as to whether postwar Brazilian economic development would have proceeded more smoothly and efficiently under some alternate form of government.

The Brazilian Experience in an International Context

The trends in Brazilian fiscal federalism summarized above were roughly paralleled by other federations in their course of development. In the years up to the end of World War II, Brazil's experience most closely resembled that of the "older" federations (United States, Canada, Australia and Switzerland) in that the bases for major changes in the federal system were crisis-oriented.[6] Before 1946, the chief crises which precipitated these changes were

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[4]This was certainly the case in Brazil where the receipt of revenue transfers from the federal government was often contingent on political support and where the proceeds were earmarked for specific purposes, e.g., roads or "rural benefits."

[5]This conflict would obviously be lessened to the extent that regional interests coincided with national interests.

[6]In this respect, the experiences of these nations were consistent with the "displacement effect" concept used to explain patterns of expenditure growth in Peacock and Wiseman's study of the United Kingdom.

the two world wars and the Great Depression. The outcome of these crises in Brazil, as in the "older" federations, was an increased role for the public sector in general and for the national government in particular. An additional similarity between these five nations was the emergence of social and economic activities as the basis for much of this growth.

A major difference between Brazil and these other countries, however, was in the relative emphasis given to intergovernmental fiscal cooperation in adjusting to these crises. The growing responsibilities of the federal government in the "older" federations were generally accompanied by an increased use of intergovernmental transfers (grants and tax shares) from the central authority to the lower administrative units. In Brazil, the growth of the federal government generally came about through partial or complete assumption of responsibilities formerly exercised by the state and/or local governments. The primary explanation of this difference can be traced to the dictatorship which ruled Brazil from 1930 to 1945 and the consequent disregard for state and local autonomy.[7]

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[7]Perhaps a more basic explanation of this difference can be attributed to the bias toward central control inherited from Brazil's pre-federation administrative organization. It should be remembered that Brazil became a federation by disaggregation rather than by aggregation.

In the postwar years, the trends of Brazilian fiscal federalism, in many ways, more closely followed those of the "emerging" federations. The basic similarity between Brazil and the newer federations is that they have all adopted the goal of rapid economic development as a prominent national priority. In this respect, the intergovernmental fiscal relations of postwar Brazil and many other "emerging" federations operated in a different context than that of the "older" and more economically developed federations.

Of special importance to the nature of fiscal federalism in the former group of nations was their almost universal utilization of public economic planning, a method seldom used in the development of the United States, Canada, Australia and Switzerland. In Brazil, the impact of national economic planning on the federal system was similar to the experience of India. The federal governments of both countries took the initiative in the planning process, a decision which led to a growing centralization of public activity. Although the states were involved in the planning process in both nations, they were only able to do so with the aid of transfers for their respective federal governments.[3]

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[8]See Wilfred Prest, "Federal-State Financial Relations in India," in U. S. Congress, Joint Economic Committee, *Revenue Sharing*, I, 476-501.

This growing use of intergovernmental transfers in Brazil and India no doubt increased the dependence of the states on the federal government.

The experiences of the Nigerian and West Indian federations, moreover, indicate that a centralization of the public finances may be absolutely necessary in carrying out national development plans. Both federations, while initially choosing to delegate the major responsibilities of planning to the lower administrative units, soon realized the complications involved in trying to implement a coherent overall plan through decentralized decision making.[9] In light of the problems of decentralized economic planning, Ursula Hicks states that it "will not be surprising if the national influence in planning tends relatively to expand."[10] This occurrence, however, will be difficult in federations where the national government has limited constitutional powers to collect internal revenues (as in Nigeria and the West Indies). The customary practice of delegating the exclusive power to obtain external financing to the federal government, though, may tend to alleviate this problem.

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[9]Brazil also encountered problems of coordination, often due to the marked decentralization of decision making *within* the national government.

[10]Ursula K. Hicks, *Development Finance* (New York: Oxford University Press, 1965), p. 142.

Another factor affecting the federal finances which has more relevance to the "emerging" federations is the existence of extreme regional disparities in income and wealth.[11] In such a situation the central authority may feel obligated to pursue a policy of horizontal fiscal adjustment in an attempt to foster a greater national standardization of public services and/or income. The preceding chapter has shown this to have been a conscious goal of the Brazilian federal government in the postwar years, especially after the creation of SUDENE in the late 1950's. Other "emerging" federations have also adopted this general policy.[12] India and Malaysia, for example, utilized intergovernmental tax sharing and grants to attain this end through using the "need" criterion as a basis for their distribution.[13] The dissolution of the West Indian federation

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[11]On a theoretical level, Myrdal contends that regional income disparities are greater in poorer nations than in richer nations. See: Gunnar Myrdal, *Economic Theory and Underdeveloped Regions* (London: Methuen & Co., Ltd., 1957) esp. ch. 3. Williamson's recent empirical study tends to support Myrdal's hypothesis. See: Williamson, "Regional Inequality," *passim*.

[12]Public policies to regionally redistribute income, however, have not been a monopoly of the "emerging" federations. Canada, Australia and, to a lesser extent, Switzerland have adopted similar policies. The United States federal government has apparently not engaged in redistributional activities on a regional basis to any great extent. On this latter topic see, for example, Selma Mushkin, "Federal Grants and Federal Expenditures," *National Tax Journal*, X, No. 3 (1957), 193-213.

[13]R. J. May, *Federalism and Fiscal Adjustment* (London: Oxford University Press, 1969), pp. 114-29.

can in part be traced to the unwillingness of the richer units to contribute to the financial support of the poorer units.[14]

In summary, it appears that the evolution of Brazilian fiscal federalism from laissez faire to the modern interventionist state, viewed in general terms, has deviated little from that of most other federations. Following the pattern set by the "older" federations, the Brazilian public sector received its initial impetus to expand and centralize from a series of crises, namely, the two world wars and the Great Depression. After World War II, the major impetus for further expansion and centralization was the same as in most of the "emerging" federations, namely, a drive for accelerated economic development. One would surmise that present trends of federalism in Brazil will extend into the future if the general desire of national development and the spector of military government are maintained.

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[14] *Ibid.*, pp. 153-54.

APPENDIX

TABLE A-1

Population According to Census Results, 1872-1960 (in thousands)

Census Year	Number
1872	9,930
1890	14,334
1900	17,438
1920	30,636
1940	41,236
1950	51,944
1960[a]	70,967

Source: Adapted from Brazil, IBGE, *Anuário Estatístico—1965*, p. 37.

[a]Preliminary results.

TABLE A-2

Gross Domestic Product at Market Prices and Real Annual Variations, 1947-64 (in billions of cruzeiros)

Year	GDP	Real Annual Variation (%)	
		Aggregate	Per capita
1947	164.9	. . .	. . .
1948	194.6	7.4	4.9
1949	229.9	6.6	4.2
1950	272.1	6.5	4.0
1951	322.7	6.0	2.9
1952	397.3	8.7	5.7
1953	469.5	2.5	-0.4
1954	627.4	10.1	6.9
1955	783.4	6.9	3.8
1956	995.9	3.2	0.2
1957	1,218.0	8.1	5.0
1958	1,457.5	7.7	4.6
1959	1,989.2	5.6	2.5
1960	2,755.5	9.7	6.5
1961	4,052.1	10.3	6.7
1962	6,601.4	5.3	2.1
1963	11,928.6	1.5	-1.5
1964	23,055.0	2.9	-0.2

Source: Adapted from "Brazil's National Accounts—New Estimates," *Conjuntura Econômica*, international ed., XVI, No. 10 (1969), 37.

TABLE A-3

Index of Prices, 1944-64[a]
(1953 = 100)

Year	Index	Year	Index
1944	35	1955	148
1945	41	1956	177
1946	47	1957	202
1947	53	1958	229
1948	56	1959	316
1949	60	1960	407
1950	67	1961	559
1951	78	1962	848
1952	87	1963	1473
1953	100	1964	2811
1954	127		

Source: Adapted from *Conjuntura Econômica*, international ed., XIV, No. 9 (1967), 99.

[a]Weighted average of wholesale prices, cost of living and building costs indexes.

TABLE A-4

Revenues and Expenditures of the Federal Government, 1900-64
(in millions of cruzeiros)

Year	Revenues	Expenditures
1900	308	434
1901	305	335
1902	344	298
1903	415	363
1904	443	463
1905	401	375
1906	432	423
1907	536	522
1908	441	511
1909	450	518
1910	525	624
1911	564	682
1912	615	789
1913	654	763
1914	423	767
1915	404	689
1916	478	687
1917	537	801
1918	619	867
1919	626	932
1920	922	1,227
1921	891	1,189
1922	972	1,428
1923	1,258	1,569
1924	1,588	1,630
1925	1,742	1,760
1926	1,648	1,868
1927	2,040	2,026
1928	2,217	2,350
1929	2,201	2,422
1930	1,678	2,511
1931	1,753	2,047
1932	1,751	2,860
1933	2,078	2,392
1934	2,520	3,050
1935	2,723	2,872
1936	3,127	3,226
1937	3,462	4,144
1938	3,880	4,735
1939	4,353	4,850
1940	4,645	5,189
1941	4,765	5,438
1942	4,988	6,343
1943	6,011	6,512
1944	8,311	8,399
1945	9,845	10,839
1946	11,570	14,203
1947	13,853	13,393
1948	15,699	15,696
1949	17,917	20,727
1950	19,373	23,670
1951	27,428	24,609
1952	30,740	28,461
1953	37,057	39,925
1954	46,539	49,250
1955	55,671	63,287
1956	74,083	107,028
1957	85,788	118,712
1958	117,816	148,478
1959	157,827	184,273
1960	233,013	264,636
1961	317,454	419,914
1962	511,828	726,694
1963	953,054	1,277,577
1964	2,010,623	2,770,714

Source: Adapted from Brazil, IBGE, *Anuário Estatístico* (various years, 1939/40-1965).

TABLE A-5

Revenues and Expenditures of the Federal Autarquias, 1947-64 (in billions of cruzeiros)

Year	Revenues	Expenditures
1947	5.4	3.3
1948	6.3	5.3
1949	9.0	6.7
1950	9.0	7.9
1951	10.8	9.4
1952	14.0	11.0
1953	17.3	17.0
1954	22.5	22.7
1955	29.0	27.3
1956	39.0	35.4
1957	53.9	51.4
1958	71.1	63.4
1959	96.7	96.0
1960	135.5	129.8
1961	235.2	203.8
1962	319.5	339.6
1963	687.0	574.2
1964	1,220.0	1,152.4

Source: Adapted from Fundação Getúlio Vargas, Centro de Estudos Fiscais, *O Setor Público Brasileiro nos Últimos Vinte Anos—Caderno Estatístico* (Rio de Janeiro, 1968), Tables 1.2 and II.

TABLE A-6

Revenues and Expenditures of the Federal District,[a] 1907-64 (in millions of cruzeiros)

Year	Revenues	Expenditures
1907	27	32
1908	39	39
1909	54	53
1910	51	50
1911	40	39
1912	48	48
1913	41	47
1914	38	40
1915	41	44
1916	42	47
1917	41	46
1918	45	48
1919	51	65
1920	58	68
1921	66	84
1922	72	101
1923	94	137
1924	109	115
1925	124	144
1926	129	130
1927	151	157
1928	168	233
1929	176	246
1930	196	233
1931	183	253
1932	183	180
1933	209	192
1934	247	257
1935	257	256
1936	287	252
1937	316	276
1938	379	349
1939	404	400
1940	423	463
1941	505	490
1942	655	621
1943	885	800
1944	1,016	915
1945	953	1,035
1946	1,396	1,389
1947	1,407	1,655
1948	1,781	1,830
1949	2,549	2,284
1950	2,918	2,778
1951	3,684	3,772
1952	3,988	4,755
1953	5,297	5,423
1954	6,211	6,451
1955	7,658	8,428
1956	10,161	11,479
1957	12,101	11,586
1958	16,302	18,025
1959	18,504	20,885
1960	26,249	29,457
1961	425	901
1962	1,213	1,144
1963	28,043	28,043
1964	47,059	47,059

Source: Adapted from Brazil, IBGE, *Anuário Estatístico* (various years, 1939/40-1966).

[a]The city of Rio de Janeiro until 1961; the city of Brasília since 1961.

TABLE A-7

Revenues and Expenditures of the States, 1907-64 (in millions of cruzeiros)

Year	Revenues	Expenditures
1907	180	193
1908	158	193
1909	190	200
1910	194	228
1911	200	227
1912	238	260
1913	229	291
1914	202	266
1915	243	251
1916	258	259
1917	278	283
1918	282	310
1919	346	336
1920	432	438
1921	432	447
1922	462	512
1923	620	663
1924	756	768
1925	945	972
1926	904	1,144
1927	1,019	1,304
1928	1,103	1,275
1929	1,265	1,536
1930	1,016	1,484
1931	1,155	1,451
1932	1,142	1,399
1933	1,133	1,292
1934	1,251	1,570
1935	1,624	1,759
1936	1,814	1,887
1937	1,819	2,059
1938	1,860	2,122
1939	2,192	2,388
1940	2,295	2,579
1941	2,684	2,803
1942	2,951	3,105
1943	3,759	3,549
1944	4,749	4,576
1945	5,426	6,008
1946	6,860	7,188
1947	7,561	8,761
1948	9,412	10,546
1949	11,374	12,566
1950	13,457	15,762
1951	19,221	20,563
1952	21,114	26,022
1953	25,180	30,470
1954	32,995	38,332
1955	40,874	44,425
1956	54,958	54,836
1957	71,590	75,040
1958	83,974	92,012
1959	127,245	128,300
1960	185,205	192,160
1961	307,490	316,002
1962	491,511	525,670
1963	640,793	720,642
1964	1,585,155	1,487,816

Source: Adapted from Brazil, IBGE, *Anuário Estatístico* (various years, 1939/40-1966).

TABLE A-8

Revenues and Expenditures of the Municipalities, 1907-64 (in millions of cruzeiros)

Year	Revenues	Expenditures
1907	72	74
1908	99	96
1909	98	98
1910	112	103
1911	108	106
1912	116	108
1913	93	100
1914	95	99
1915	100	107
1916	101	106
1917	106	107
1918	112	113
1919	120	152
1920	136	139
1921	149	163
1922	161	176
1923	192	220
1924	216	234
1925	270	277
1926	296	302
1927	334	357
1928	383	422
1929	424	463
1930	386	416
1931	413	409
1932	397	405
1933	419	433
1934	437	431
1935	451	438
1936	608	605
1937	673	673
1938	752	746
1939	860	912
1940	937	922
1941	1,015	983
1942	1,065	1,097
1943	1,164	1,123
1944	1,320	1,335
1945	1,443	1,596
1946	1,723	1,807
1947	2,235	2,347
1948	2,822	2,899
1949	3,754	4,054
1950	4,794	5,196
1951	5,582	5,870
1952	6,672	7,287
1953	8,785	8,832
1954	10,152	10,728
1955	12,979	13,515
1956	17,053	17,535
1957	22,848	23,981
1958	27,050	28,539
1959	34,104	34,084
1960	44,992	46,019
1961	62,025	63,574
1962	94,292	100,392
1963	177,678	194,864
1964	415,741	495,785

Source: Adapted from Brazil, IBGE, *Anuário Estatístico* (various years, 1939/40-1967).

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This dissertation was prepared under the direction of the chairman of the candidate's supervisory committee and has been approved by all members of that committee. It was submitted to the Dean of the College of Business Administration and to the Graduate Council, and was approved as partial fulfillment of the requirements for the degree of Doctor of Philosophy.

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